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ABSTRACT

This report describes a study aimed to help education advocates protect public schools and services from the effects of certain types of economic development subsidies. These subsidies include cutting companies' property taxes and granting long-term diversions of certain districts' property taxes to corporations making investment in those districts. The study examined subsidies in all 50 states and the District of Columbia by researching statutes, news reports, and other studies and by interviewing leaders and staff of state school board associations, tax departments, and development agencies. The report examines the extent and cost of these tax subsidies nationwide and details conditions and policies in Ohio, Florida, Minnesota, Montana, and Texas. The study's detailed examinations of these five states reveal a mixture of success and problems in coping with the effects of abatements on education. Overall, the report casts doubt on whether such subsidies promote balanced economic development. The report shows how these subsidies can harm public education by diverting funding that local schools need to sustain their educational mission. The study suggests that today's development subsidies may be enriching corporations at the cost of the education of tomorrow's work force. Appended are: Research Methodology and Scope; State Funding Formulas and Local Property Tax Subsidies; Organizations Surveyed; Roles of School Boards in Awarding Property Tax Abatements; Roles of School Boards in Tax Increment Financing; School Board Opposition to Abatements, TIF; Can School Boards Negotiate a Payment in Lieu of Tax (PILOT)?; State Reimbursement for Abatements, TIF; and States in Which School Board Association Engaged in Subsidy Debate. (Contains 69 references, 19 tables, and 4 figures.) (WFA)

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Protecting Public Education

From Tax Giveaways to Corporations

Property Tax Abatements, Tax Increment Financing, and Funding for Schools

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NEA RESEARCH
WORKING PAPER

January 2003

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From Tax Giveaways to Corporations

Property Tax Abatements,
Tax Increment Financing,
and Funding for Schools

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Preface

NEA Research commissioned this study by Good Jobs First, a project of the Institute for Taxation and Economic Policy. Like these nonprofit, nonpartisan research groups, the NEA has been concerned for some time about state fiscal policies and has sought to advise states on ways to protect and enhance funding for quality education. NEA Research has long maintained that quality education requires comprehensive and well-coordinated tax and economic policies at state and local levels. An equitable and adequate funding system for public education can hardly flourish when state and local tax structures become more regressive and fall into serious deficit; school systems cannot function effectively when revenues earmarked for modernizing school buildings are instead diverted to corporate property tax abatements and other subsidies.

This study is part of a larger NEA Research effort to enhance education advocates' capacity to monitor the trends in state fiscal policies and in the equity and adequacy of school finance. In this larger effort, NEA Research has been developing several databases with easy-to-use map-based interfaces to facilitate research at the national and state levels. These databases—available or soon to be available to NEA state affiliates through the Association's Intranet, *Connect* (with highlights on the NEA's Internet site, nea.org)—include the following:

- *State Fiscal Profiles*. These include information on state fiscal conditions and structural deficits. (Now accessible on *Connect*.)
- *State Equity Litigation*. This compilation comprises summaries of lawsuits and court decisions in the states that bear on the equity and adequacy of school funding across districts. (Now accessible on *Connect*.)
- *Rankings & Estimates*. This Intranet tool includes current-year and long-term trend data on education revenues, expenditures, teacher salaries, enrollment, and other school statistics from the NEA's now-classic publication of the same name. (Accessible on *Connect* in late 2003.)

NEA Research is also developing several new databases, including one that would help individual states measure the gap between current and adequate levels of funding and one that assembles and facilitates access to state-level indicators of educational excellence. In addition to collecting and disseminating data, the department also continues to explore policy issues and directions for reform that emerge from research. Toward that end, NEA Research has investigated the deepening structural deficits in many states, the funding needed to modernize schools, the impact of deferring taxation of Internet commerce,

and the effectiveness and equity of different types of taxation in raising funding for education.

The present study focuses on an important aspect of education funding—property taxes and the policies that shape them. Local jurisdictions raise 45 percent of total U.S. funding for K–12 education, and local property taxes alone account for 29 percent of the U.S. total. The continuing reliance of public education on these local resources makes it vital not merely to observe events but also to understand and respond to threats to the flows of this funding to the schools. The NEA supports reasonable, equitable, and well-planned taxation that keeps public services healthy and available to the citizenry. That doesn't necessarily mean raising taxes or opposing all tax cuts. The point is that in fiscal matters, passivity and impulsive reactions alike can harm education. California, for example, fell from front-runner to the back of the pack in levels of per student funding when Proposition 13 slashed property taxes without protecting education.

The present report probes state and local governments' increasing support of corporate property owners through grants of long-term property tax abatements and diversion of property tax revenues for tax increment financing (TIF). Few would debate the logic of using public financing as a tool of development in some cases—especially if was demonstrably effective in rehabilitating distressed areas in the nation's cities, providing affordable housing, creating meaningful and durable employment opportunities, and jump-starting self-financing renewal. This report, drawing on the available research literature and its own survey of the states, casts doubt on whether most subsidies for corporate property tax abatements and TIF meet such criteria. Instead, the report suggests that over the last 25 years, corporations have more often used these subsidies as quiet conduits for diverting public revenue to private benefit.

The problem has remained unrecognized and the controversy low key partly because the subsidies are tax expenditures (i.e., revenue not collected or revenue diverted) rather than outright budget allocations. In addition, an exact dollar accounting is difficult to tease from the records of the myriad jurisdictions that give out the subsidies. Reasonable estimates show, however, that the amounts—perhaps some $50 billion per year—are far from trivial. And despite the enormous injections of public funding they have received, subsidized corporate development schemes have not really delivered on their promises of public benefits. Too often, these poorly monitored subsidies have gone to low-density industrial parks; tourist, convention, and shopping destinations; and other enterprises that may not really need special public support, do not create long-term jobs with decent wages, and contribute little to community infrastructures as a whole. Moreover, paying businesses to shift their operations from one location to another or even just to stay put—as has happened most visibly with the financing of some sports stadiums—is likely to offer no net benefit for the economy as a whole. What one area may gain, another may lose. That is poor policy at any level.

Much of the fact-finding and analysis of the effects of property tax subsidies must focus on the local level. Although state governments have the power to authorize property tax abatements and TIF, city and local governments are the ones that issue them. The amounts, conditions, and effects of these subsidies differ widely between jurisdictions. A very few states explicitly protect all education funding from the impacts of these subsidies. Others compensate school districts in part, and many that do so are becoming painfully aware of the accumulating burden this places on state budgets. Yet they also know what failing to fill this gap would do to local public services.

In addition to outlining the status of tax subsidies across the country, this report details conditions in five case-study states: Ohio, Florida, Minnesota, Montana, and Texas. The NEA and NEA Research seek feedback from state and local governments as well as from NEA affiliates, educators, and the public regarding the extent and operation of local tax subsidies that affect education. We hope that together we can develop a more complete picture of the facts and share our thoughts on various approaches to the issue.

In the meantime, the study suggests that educators and citizens who are knowledgeable about development subsidies can help bring the facts to light and make their effects on education more visible. As the front-line workers who see the immediate impacts of overcrowding and program cuts, teachers and other education employees can articulate the dangers of underfunding our schools. They can also join with parents and proponents of public education to press local and state governments for legislation and rule changes that would curtail excessive or unproductive abatements and that would empower school districts and communities to protect education funding more effectively.

Education advocates have already been successful in shielding some schools from harm caused by abatements. Yet most states and localities still deny school boards any real leverage to review and curtail the most significant business subsidies—property tax abatements and TIF. Ultimately, educators, students, and the public as a whole benefit if they make decisions about how to use their communities' resources in the light of clear and common understanding of subsidies' costs and consequences. Effective public education is today's best legacy to tomorrow. That gives education advocates and other community interests common ground for considering quality public schools as an integral part of balanced development.

NEA Research would like to thank Greg LeRoy, director of Good Jobs First, and research analysts Kate Davis, Sara Hinkley, and Rebecca Heck, for their dedicated and responsive work on this paper. For further information about GJF programs and publications, see their Web site, *http://www.goodjobsfirst.org*. Also of interest are several GJF publications, including LeRoy et al. (1994), Hinkley (2000), and LeRoy and Hinkley (2001).

For questions about this paper, please contact Ed Hurley or Paul Wolman at NEA Research, 202/822–7400.

Executive Summary

This study aims to help education advocates protect public schools and public services from the effects of certain types of economic development subsidies. These subsidies—which state and local governments often dispense in response to corporate lobbying for a good "business climate"—include cutting companies' property taxes and granting long-term diversions of certain districts' property taxes to corporations making investments in those districts (the latter is called tax increment financing, TIF). Some abatements and TIF districts help revitalize distressed areas, create opportunity for low-wage workers, build or rehabilitate affordable housing, and otherwise stabilize low- and moderate-income communities. But as abatements and TIF have proliferated, they have often strayed from their original antipoverty intentions. This report does not condemn all abatements or TIF; it does argue that all parties affected by such expenditures ought to have a say in them.

The report examines the extent and expense of these tax subsidies around the country, and it details conditions and policies in five states: Ohio, Florida, Minnesota, Montana, and Texas. Overall, the report casts doubt on whether such subsidies promote balanced economic development, especially on the expanding scale at which governments are dispensing them (one estimate puts the cost at nearly $50 billion per year). Most importantly, the report shows how these subsidies can harm public education by diverting funding that local schools badly need to sustain their educational mission. Public schools are particularly vulnerable, because local property taxes are now the largest single source of funding for public education, amounting to about 65 percent of all local education funding and 29 percent of total education funding (local, state, and federal).

The researchers looked at abatements, TIF, and school finances in all 50 states and the District of Columbia (hereafter included in the count of "states") by researching statutes, news reports, and other studies and by interviewing the leaders and staff of state school board associations, tax departments, and development agencies. The paper indicates that 43 states allow cities or counties to give companies significant, long-term property tax abatements—tax "holidays" that may last 10 years or more. And 48 states allow cities to divert local property tax revenues into special redevelopment areas, TIF districts, for as many as 30 years. The full extent of all subsidies is exceptionally difficult to track in exact dollar terms, as the details reside in myriad local jurisdictions and, as tax expenditures rather than direct allocations, often do not appear directly in budgets. The information we collected, however, reveals some important features of the problem:

- *All 50 states offer either abatements or TIF or both.* In 32 states, respondents report that one or both of the subsidies divert funding from schools. In 14 more, interviewees did not know how these subsidies affected

school revenue. Thus, schools in at least two-thirds of the states appear vulnerable to the loss of revenue to abatements and TIF.

- *Educators are putting development subsidies under increasing scrutiny.* At least 18 state school board associations have researched or lobbied on the issue.
- *Some states are providing aid to local school districts that helps cushions revenue losses from abatements and TIF.* But respondents in 16 states said their states do not reimburse schools adequately for abatement losses, and respondents in 15 states reported inadequate reimbursements for funds diverted to TIF.
- *School boards in Kansas, Minnesota, Ohio, Pennsylvania, and Texas have gained a formal say over whether the school portions of property taxes can be subject to abatement.* Five other states require that local governments notify their school boards of proposed abatements and give them a chance to comment. The rest of the states apparently grant school boards informal roles or no role at all.

One of the most fundamental and problematic features of the issue emerged from our conversations with state-level officials, several of whom pointed to an intrinsic contradiction between abatements and development. That is, when companies grow, build facilities, and bring in staff and their families, they increase local school enrollments and generate demand for more teachers and classrooms. But if the new corporate property has a tax abatement, it then fails to generate the necessary revenues to increase school capacity to serve the enrollment it has created. Under such circumstances, school funding can fall short, local governments may raise homeowners' property taxes to compensate, or both.

The study's detailed examinations of Ohio, Florida, Minnesota, Montana, and Texas reveal a mixture of successes and problems in coping with the effects of abatements on education:

- *Florida shields school revenues from both abatements and TIF.* It is one of only four states to do so (the others are Alaska, Maryland, and South Dakota).
- *School districts in Texas have had the power to veto all school property tax abatements since 1987.* Moreover, the number of Texas school districts choosing to participate in abatements dropped off considerably after a 1993 state law cut off state reimbursements. However, local schools still forgo $52 million each year to abatements and TIF.
- *Minnesota has more than 2,100 TIF districts that cost state taxpayers an additional $112 million in 1997.* These monies were in the form of additional state aid payments to local school districts. But TIF may enter a tailspin in Minnesota as a new school-funding formula takes effect.
- *Abatements and TIF in Ohio reduced or diverted school property tax revenue for schools by $102 million in 1999.* The state shouldered most of the costs by providing aid to local school districts. But local districts also lost potential revenue, because the state aid does not cover tax breaks affecting levies for capital outlay and debt service. School boards in Ohio play an advisory role in economic development decisions.
- *Montana schools forgo about $16 million a year to subsidies.* They also face declining support from the state, declining enrollments in some areas, and residents' demands for lower property tax rates in response to booming home prices.

This study suggests that today's development subsidies may be enriching corporations at the cost of the education of tomorrow's work force. Moreover, extensive corporate subsidies can be self-defeating if their main effect is to sap the funding of quality local public schools, because in doing so they may be undermining the attractiveness of an area to the highly skilled work forces that businesses increasingly seek. As part of state or national economic policy, extensive subsidies also make little sense if their principal effect is to pit states, cities, and counties against each other to attract businesses through escalating rounds of subsidies. That is, such bidding wars may enrich corporations by inducing them to move, but what one area gains another loses. The subsidies thus are unlikely to result in much net economic growth. The key problems can be summed up as follows:

- *In many states, data collection on subsidy deals is so poor that it is almost impossible to measure the costs and the outcomes of these programs.* In addition, few granting authorities have armed themselves with any means to "claw back" subsidies dispensed to corporations that have failed to yield expected public benefits.
- *School officials have very little say over these programs.* Except in a small handful of states, local school officials have no voice in how substantial portions of the monies originally intended for schools are ultimately spent.

- *Abatements and TIF cost schools millions of dollars in revenue each year.* Not every state is affected, but most are.

What then can states and localities do? This study provides some initial policy options and recommendations:

- *Improve disclosure of subsidies.* States should measure the impact of subsidies on school revenue. In order to do this, they must collect reliable data on property tax abatements and TIF and aggregate it by school district, county, and state. School boards and the public should have full, advance information about subsidies to make informed decisions. In addition, the public will not have to bear the entire brunt of a mistake if development agreements provide in advance for a clawback of subsidies from companies that fail to deliver on jobs, wages, or capital investment.
- *Give local school boards authority in subsidy decisions.* Giving school boards a formal say in subsidy decision-making is a first line of defense for school funding. If school boards have explicit veto power over abatements and TIF, they can effectively protect education.
- *Seek to have the state government shield school revenues from the effects of subsidies.* One of the best ways to protect school revenues from subsidies is for the state government itself to prohibit the abatement or diversion of the school portion of property taxes. As we noted earlier, a handful of states have already done this. Most states, however, do not prohibit property tax subsidies and reimburse schools for them only partially, typically to cover operating expenses, or not at all. Some states also protect school levies earmarked for capital outlay or debt service from abatement or diversion into TIF. More could do so. By promoting exclusion of funds for schools' capital outlay or debt service in states that do reimburse districts for schools' operating expenditures, local districts could create a shield made up partly by reimbursement and partly by statutory or regulatory restriction of the scope of subsidies. The permutations of such combined approaches would of course vary with the particular statutes and practices in each state.

States and localities control abatements, and some have effectively protected their public services, including education, from losing resources to property tax abatements and TIF. As this report details, the regulations differ from state to state and are often complex. But states can learn from other states' experiences. This report is a first effort to survey those experiences systematically. Education advocates in the states, cities, and counties will need to understand and discuss the specific policies and practices in their own areas and work in their communities to define solutions that effectively protect jobs, encourage growth, and promote quality public education.

1

Corporate Tax Subsidies and the Dilemma of Public Education

The generous tax breaks that state and local governments are giving to corporations are creating a serious problem for public education in the United States. For some time, corporations have been convincing state legislatures, county boards, and city councils to lower businesses' taxes to foster a better "business climate." Such uses do not necessarily foster the original antipoverty objectives of abatements and TIF districts—to help revitalize distressed areas, create opportunity for low-wage workers, build or rehabilitate affordable housing, and otherwise stabilize low- and moderate-income communities. Moreover, when businesses get property tax abatements or diversions for 10, 20, or even 30 years, the flow of revenue into public coffers diminishes, and K–12 schools and other educational programs are often left high and dry.

Local property taxes are a key source of funding for today's schools, supplying almost a third of the budgets for public K–12 education (U.S. Census Bureau 1998). Corporate property tax subsidies can hit this vital source of revenue a severe blow. This issue arises because many states and cities have been giving corporations long-term abatements of these taxes as enticements to build facilities within their jurisdictions. Tax increment financing (TIF), a property-tax diversion device, is another aspect of this same issue. The effects of these tax breaks go beyond the local level, because local abatements are often bundled as part of state-regulated enterprise-zone subsidies, thus also diverting to business state funds that could be going to education.

Meanwhile, local and state financial resources are limited, both in the short and long term (see, e.g., Hovey 1998). Thus, the business subsidies typically come at a cost to other state and local programs. For local governments in particular this typically means infrastructure and education. The loss to the public of tax revenues is thus no minor issue, especially when these potential revenues flow into unnecessary tax giveaways to businesses. Saying this is not to condemn all abatements or TIF projects, but it is to argue that all parties affected by these tax expenditures ought to have a say in them.

The High-Stakes Game of Corporate Subsidies

The tendency of local and state governments to spend more and more for business tax breaks has continued for nearly a generation—to the point where some analysts have depicted it as an "economic war among the states" (Rolnick and Burstein 1995). How has the competition among states to attract businesses escalated? In 1977, 9 states gave tax credits for research and development; in 1998, 36 did. In 1977, 13 states made loans for machinery and equipment; in 1998, 43 did. In 1977, 20 states provided tax-free revenue bonds; in 1998, 44 did. In 1977, 21

states granted corporate income tax exemptions; in 1998, 37 did (Chi and Hoffman 2000).

Several factors have sustained the trend toward expanding tax breaks. Corporate lobbyists have sought tax abatements or tax cuts in preference to direct appropriations to businesses (such as grants) because legislatures and the public do not scrutinize tax-based subsidies as carefully as they do outright appropriations. That is, once states enact tax cuts, they seldom audit, evaluate, or "sunset" them. Such cuts are also far less transparent in aggregate than are appropriations. No state discloses corporate income tax returns to the public. Most do not publish reliable aggregate data on how much money they do *not* collect in the name of promoting economic development. And although local property tax records are usually available, they reside in a multitude of county tax offices and seldom appear in a user-friendly format.

Lobbyists also prefer tax cuts because they are less visible in budgets than direct spending and hence less likely to go on the chopping block during tight economic times. In addition, once they are able to build tax breaks into the tax system, business beneficiaries often criticize efforts to reduce the subsidies as "tax hikes" or "tax and spend" proposals.

But it is not only the business community that defends corporate tax breaks. State and local governments also protect these subsidies when they adopt a "jobs at any cost" philosophy that forgoes fiscal break-even or economic cost-benefit analysis and pays little if any attention to the real costs of the subsidies or of costly externalities that they may involve, such as pollution or poverty-level wages. One sociologist described this prodigal practice as shooting everything that flies and claiming anything that falls (Rubin 1988, p. 237).

The underlying assumptions of all this business and legislative activity have been that abatements produce a good business climate for development—particularly in the cities—and that this in turn means economic growth and more jobs. But business "climatology" is one of the most conflict-laden areas of public policy, and no clear consensus has emerged on whether corporate tax abatements really boost local economies and create jobs in the long run (see, e.g., Minietta 1996). One factor casting doubt on the efficacy of tax abatements in this regard resides in the history of corporate manipulation of the business climate index. A study by the Corporation for Enterprise Development (1986) revealed, for example, that the Chicago accounting firm Grant Thornton, publisher of the then-dominant business climate index, allowed each state's manufacturers' association to weight various tax factors each year. This self-weighting allowed manufacturers to portray taxes they were currently contesting as the factors hindering growth—even without evidence that these taxes had influenced corporate behavior. The manufacturers used the "low" ratings of the tax factors as they lobbied to reduce or eliminate the taxes.

Another boldface question mark should follow the assertion that subsidies promote the long-term economic well being of the public. To begin with, a Congressional Research Service report (Maguire 2000) confirmed that the net tax state and local burden has been shifting *away* from corporations and onto individual property owners, wage earners, and consumers. This report noted that the effective rate of state and local taxes on corporate profits, which averaged 6.5 percent in the 1980s, had fallen to 3.8 percent by 1998—a drop in the effective rate of more than 41 percent for the period as a whole. The report concluded that "perhaps the most obvious explanation is the tax competition among states to attract businesses" (p. 7).

Another study (Fisher 2002) supports the CRS's conclusion (Maguire 2000) that the increase in tax incentives granted by states and localities has played a role in the declining tax burdens of corporations. Fisher projected fiscal flows and corporate tax rates for 20 state and local tax systems and representative models of firms in 16 manufacturing sectors. His analysis suggests that the statutory changes in state tax rates were probably the most significant factor in the declining corporate income tax rate nationally between 1988 and 1998. But he points directly at corporate tax incentives as the most influential contributing factor.[1]

Of particular interest here, Fisher (2002) found the negative fiscal effects of corporate incentives "large and growing." He calculated that in the 17 states that offered general incentives, these incentives accounted for only 9 percent of the new jobs created. The cost, across the 16

1. Fisher sought to pin down more precisely the influence of various factors that might be responsible for the decline in the corporate taxation rate. These include legislative changes in tax rates; revisions in tax apportionments by type of tax (e.g., as described by Mazerov 2001); corporate legal strategies that facilitate tax avoidance; and of course the influence of the business cycle itself. Mazerov (2001) had observed that 34 of 45 states with corporate income taxes have shifted the weighting of these taxes from systems allocating a third to each of property, payroll, and in-state sales to ones that weight sales from 50 to 100 percent. This shift toward a "single sales factor" or to a "double-weighted sales factor" is a tax windfall for in-state manufacturers.

Box 1.1: Corporate Property Tax Abatements: What Benefit to the Public?

States and localities have been using tax subsidies over the past 25 years to attract businesses to their areas. Their assumption has been that such subsidies promote local economic development. But do they? The idea that subsidizing corporations with tax breaks is the best way to promote local development and higher employment does not have a real consensus (Mineeta 1996).

Many tax subsidy schemes have clearly not produced the desired development benefits. As early as the late 1970s, Pennsylvania offered subsidies amounting to about $70 million to a European auto manufacturer to attract more than 10,000 manufacturing jobs. The plant employed, at a maximum, 6,000 people, and it closed within a decade. In the early 1990s, Alabama got another European auto manufacturer to locate an assembly plant in state in return for subsidies of about $253 million—a cost of nearly $169,000 for each of the 1,500 jobs directly created (Minge 2000). In the same period, South Carolina and some other southern states made offers to auto manufacturers at costs of between $50,000 and $150,000 per job created (Mastel 1996).

Examples abound as well of cities subsidizing the building of stadiums through tax breaks to attract or keep baseball and football teams. Team owners and some highly paid players may profit. But do such subsidies help cities and the public? That is questionable, because the infrastructural improvements may be too concentrated (e.g., low-use stadiums and vast parking lots for holders of high-priced tickets), and most of the new employment they create is low-wage and seasonal (Minge 2000).

Luring corporations with subsidies is a game that many can play as well as one. New York City's efforts to stop Connecticut and New Jersey from wooing its financial, publishing, and media firms have involved countersubsidy offers in the many millions of dollars—at *no* net gain in jobs. At best such subsidies may only shift companies and jobs from locality to locality or state to state—a zero-sum game. In any case, governments and the public may ask whether the costs of the jobs created are too high, and their value too minimal or short-lived to justify public support of corporate mobility.

manufacturing sectors that Fisher modeled, was about $46,000 per job gained through incentives. In fact, over the 20-year period of Fisher's projections, none of the 17 states achieved a positive fiscal flow as a result of revenue gained from corporate-incentive-based job creation, and even in year 20 of the projection, the per job revenue *loss* was still $6,500 annually. Taken together, the foregoing analyses strongly suggest that the public is paying a larger share of taxes and is receiving meager employment and economic benefits in return.

Still further doubt arises from two decades of prominent subsidy schemes that had costs of $50,000 and up per job created (Box 1.1).

A complete accounting of the total taxpayer cost of economic development subsidies is difficult because few states publish clear pictures of their *tax expenditures*. That is, they do not clearly account for revenues *not* collected in the name of economic development as opposed to expenditures made as direct budget *appropriations*. Many other states publish incomplete and inconsistent tax expenditure budgets. And only a few maintain centralized data about local property tax abatements. We do know, however, that tax spending for economic development outweighs direct spending by significant margins in many cities and states. For example, a study of North Carolina found that tax spending for development exceeded direct spending by four to one and that tax spending was one of fastest-growing items in the state budget (Schweke and Rist 1997: 2). Another study (Thomas 1996) estimated that by the mid-1990s, states and cities' annual spending for business development subsidies totaled nearly $49 billion.

because they have large amounts of property and big payrolls. Moreover, 20 states have no provision requiring a "throwback" of sales taxes on goods exported to states where the original state's businesses have no tax nexus and are thus not already required to treat the sales as "in-state." This again compounds the shift of the tax burden onto noncorporate taxpayers in the state, could account for the decline in the overall rate of corporate taxation seen in the 1990s, and gives more prominence to the role of property taxes as sources of local government revenue.

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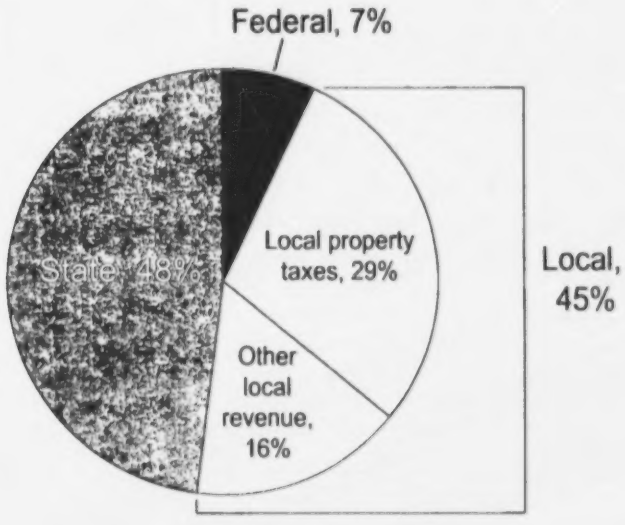
Figure 1.1 Sources of Revenue for Public Schools, 1998



Source: U.S. Census Bureau (1998).

One of the biggest problems inherent in business-climate subsidies is its "stealth" aspect. Most states do not have a clear overall accounting and assessment of their effects. A U.S. Department of Commerce survey of state practices found that only Maryland and New York have invested in the technical capacity to do fiscal impact analysis of incentives. "Other states rely on estimates of impacts derived from client companies or do not collect data at all," the study found. In other words, 48 states still rely on the self-interested calculations of the companies that benefit from the subsidies in estimating their return on taxpayers' investments (U. S. Department of Commerce 1999: iii). Chapter 4 of this report presents studies of tax abatements and TIF in five states as a first attempt to fill in some of the details. But clearly we have much more to learn about fiscal practices and the details of subsidy measures before we can assess the full impact of corporate tax subsidies around the nation.

The Implications for Schools

Even if we do not yet have the bottom line on corporate tax abatements and TIF, we can see the broad implications for public education. As Figure 1.1 shows, state and local sources each supply almost half of school funding. Federal support is only 7 percent. Local property taxes alone contribute 29 percent and (because state funds come from several programs not separately shown in the figure) represent the largest single source of school funding (U.S. Census Bureau 1998).

It is not surprising to find property taxes playing a large role—about two-thirds, actually—in local funding of education. Local governments have few resources to support direct spending programs, so property taxes are the primary source of revenue for most local governments. By the same token, lacking resources for direct spending, localities tend to rely heavily on tax spending for economic development, and property tax abatements are the most common locally granted economic development subsidy. This practice has significant implications for public schools, because the abatements compete directly for schools' largest revenue source.

Local property taxes are lost to schools primarily through two subsidies: property tax abatements and tax increment financing or TIF. Some states target or bundle abatements as part of enterprise zones. Therefore, abatements and TIF are the focus of this study. The next two chapters describe in somewhat greater detail how these tax subsidies operate and convey the study's general findings on their prevalence and impact on public education around the United States.

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2

Property Tax Abatements and TIF

We focused our study on the two subsidies that most affect property tax revenues: property tax abatements and tax increment financing (TIF).

Property Tax Abatements

A property tax abatement is an economic development subsidy that local governments offer routinely in the belief that it contributes to attracting or retaining businesses. When a company receives an abatement, the government is exempting all or some of the value of the company's property—real, personal, or both—from property taxes for a specified number of years. (Real property includes the land and the buildings within a parcel of property. Personal property includes the inventory, machinery, or other equipment that a business owns and uses.)

Although city councils, county boards, or other local bodies generally control property tax abatements, the states are responsible for legally enabling and regulating them. A total of 37 states now allow tax abatements, and 6 more permit abatements in enterprise zones, for a total of 43 states altogether. Jurisdictions most often give the most generous tax abatements to new property improvements—for example, when a business facility expands or acquires new machinery. The abatements are for a fixed period, generally between 5 and 20 years, and sometimes decline or phase out over that period.

States typically limit the amount of property eligible for exemption and specify the duration of abatements. State laws also typically restrict abatements to certain kinds of companies. They may also impose quid pro quo requirements on them. For example, companies may have to agree to create or retain a certain number of jobs or invest a certain amount of capital to receive or continue to receive an abatement. Or they may have to locate within a state-designated enterprise zone. The local granting bodies may also impose additional requirements, such as wage standards and health care benefits.

Although most states cannot grant property tax abatements directly, state officials often bundle them into multiyear packages of incentives for corporations, intending to refine the arrangements later with the local jurisdictions that technically grant the abatements. The impulse to put property tax abatements on the table first reflects the fact that for capital-intensive facilities such as steel mills, petrochemical plants, or microchip fabrication plants, a company's property tax liability may exceed its

corporate income tax bill, especially in start-up years. Local property tax abatements thus are often the largest economic development subsidy a company receives.

Tax Increment Financing

TIF is a highly flexible development subsidy based on *diversion* of property taxes (and, in some states, sales tax as well). As is the case for abatements, the states enable and regulate TIF, and the cities or local jurisdictions implement it. TIF usually aims to revitalize "distressed" or "blighted" areas; state rules therefore establish measures of distress or blight that qualify an area for TIF (Johnson and Kritz 2001).

When a city designates a TIF district, it anticipates the redevelopment of an area and a resulting rise in property values and property tax revenues. When that happens, the TIF provides for splitting the future property taxes for that area into two streams. The first stream, pegged to the area's original property values (*base value*) continues to go where it always has—that is, to support local services such as schools, police, fire and sanitation—for the city as a whole. But all of the *increase* in property taxes—the *tax increment*—now goes to subsidize the redevelopment of the TIF district. Thus, within the TIF district, the increased future property taxes may pay for upgrades of the district's public roads, sewers, or lights. In some states, they may also pay for improvements to private buildings or land. TIF thus channels the increment to private as well as public purposes.

Figure 2.1 shows how a TIF scheme might divide the property tax stream over 20 years.

Although developers like to say that the tax increment would not exist without the building facilitated by the subsidy, this may not be so. A recent study in Chicago suggests that many districts were growing before or without TIF. When that is the case, the city as a whole loses the benefit of taxing the resulting economic growth (Neighborhood Capital Budget Group 2000).

A TIF tax diversion may last from 10 to 30 years, depending on state rules. States may also limit how much property a city may include in TIF or how much tax revenue it can divert into TIF schemes. Based on revenues it anticipates from a TIF plan, a city may float bonds to generate a large amount of cash up front for redevelopment and then use the incremental revenue from the TIF later on to service the bond debt. More conservatively, a city may use TIF revenues to subsidize redevelopment on a pay-as-you-go basis (Johnson and Man 2001).

Figure 2.1 Hypothetical Increase in Tax Increment versus Constant Taxes Collected on Base Value

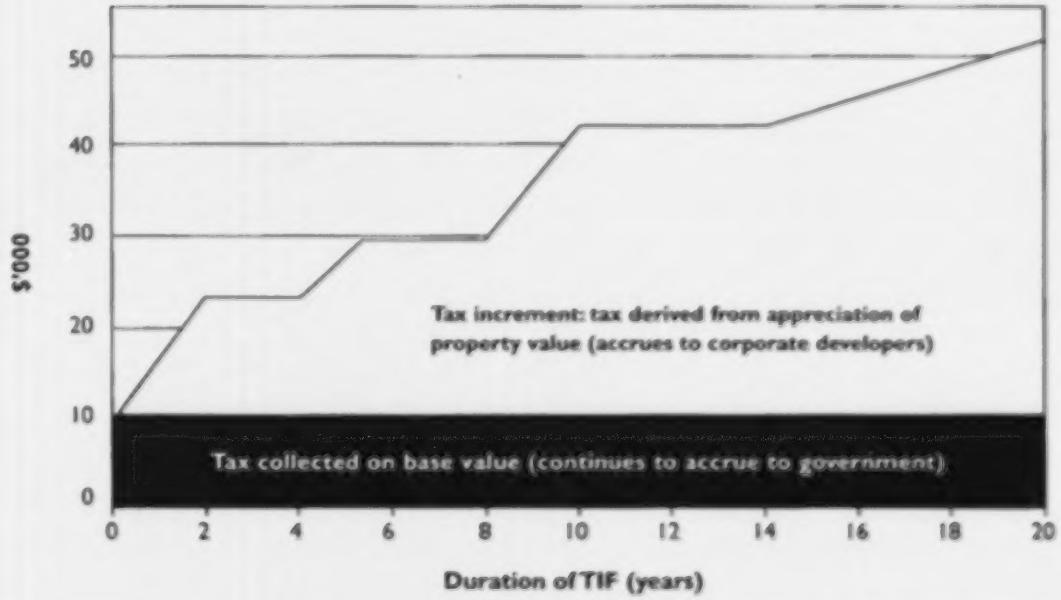

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Table 2.1 States' Use of Property Tax Abatements, TIF, and Enterprise Zones

State	*Property tax abatement*	*Tax increment financing*	*Enterprise zone*	*Property tax abatements in enterprise zone*
Alabama	■	■	■	■
Alaska		■		
Arizona	■		■	■
Arkansas	■	■	■	
California	■	■	■	
Colorado	■	■	■	■
Connecticut	■	■	■	■
Delaware	■			
Dist. of Columbia	■	■	■[a]	
Florida*	■	■	■	■
Georgia	■	■	■	■
Hawaii		■	■	■
Idaho		■		
Illinois	■	■	■	■
Indiana	■	■	■	■
Iowa	■	■	■	■
Kansas	■	■	■	■
Kentucky*	■	■	■	■
Louisiana*	■	■	■	
Maine		■	■	■
Maryland*		■	■	■
Massachusetts		■	■	■
Michigan	■	■	■	■
Minnesota	■	■	■	■
Mississippi	■	■		
Missouri	■	■	■	■
Montana	■	■		
Nebraska	■	■	■	
Nevada	■	■		
New Hampshire	■	■		
New Jersey	■	■	■	
New Mexico	■	■	■	■
New York	■	■	■	■
North Carolina	■		■	
North Dakota	■	■		
Ohio	■	■	■	■
Oklahoma	■	■	■	
Oregon	■	■	■	■
Pennsylvania	■	■	■	■
Rhode Island	■	■	■	■
South Carolina	■	■	■	
South Dakota		■	■	
Tennessee		■	■	■
Texas	■	■	■	■
Utah		■	■	
Vermont	■	■	■	
Virginia		■	■	■
Washington*		■	■	
West Virginia		■		
Wisconsin		■	■	
Wyoming		■		

*States in which TIF is not applicable to the school portion of property tax revenues. ■[a]Federal, not local, program.

Source: Individual state statutes examined by authors.

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California first allowed tax increment financing in 1952. Now all states allow it except for Arizona, Delaware, and North Carolina. Washington State only recently legalized TIF, and Washington, D.C., authorized it just a few years ago. California, Colorado, Florida, Illinois, Indiana, Minnesota, and Wisconsin use TIF extensively. Connecticut and Washington, D.C., allow TIF districts to capture both property and sales tax revenues. Alaska has allowed TIF for several years but has never used it; a recently enacted law aims to change that.

Only Florida, Louisiana, Kentucky, Maryland, and Washington specifically prohibit school districts from participating in TIF districts (Johnson and Man 2001: 49).

Table 2.1 sums up the present study's findings on the 50 states' statutes on abatements and TIF. A total of 36 states plus Washington, D.C., now allow tax abatements, and 6 more permit abatements in enterprise zones; 47 plus Washington, D.C., have TIF. Clearly, forgiving or diverting property taxes has become a common practice of economic development across the United States.

3

Abatements, TIF, and Schools

We surveyed school board associations and other education organizations in 49 states and the District of Columbia (hereafter included in references to states) to collect basic information about the role of school boards in subsidy decisions and the impact of subsidies on school revenues, focusing especially on abatements and TIF. We did not survey officials in Hawaii, where state revenues (not local property taxes) support the schools. The full results of the survey appear the appendixes to this report.

Finding 1: Schools in at Least Two-Thirds of the States Are Affected

Our research in states' statutes indicated that 43 states allow local governments to offer property tax abatements, and 48 states permit tax increment financing. We then surveyed state school board association officials and others to (1) determine the effects of abatements and TIF on school revenues and (2) find out whether school boards have any power to protect their revenues from these subsidies.

As Table 3.1 shows, among the 43 tax-abatement states, school district revenues are vulnerable to abatements in at least 25. In only 5 of the 43 states did respondents report that their state protected the schools' portion of property taxes from abatement. In 11 other states, respondents did not know. Given the prevalence of vulnerability among the 32 states for which we did obtain answers, we feel justified in assuming that the number of states in which schools may be affected by abatements is substantially higher than 25.

Among the 48 states that permit TIF, at least 22 permit diversion of school taxes. In only 8 TIF states did respondents report that TIF does not affect school property taxes. In another 17 states, respondents did not know. Again, given the prevalence of vulnerability for the states for which we obtained answers, we assume that the number of states in which TIF may affect schools is much higher than 22.

Combining the results for both kinds of subsidies, we find that all 51 U.S. jurisdictions (i.e., the 50 states and D.C.) offer one or both of the subsidies, and that in at least 31, abatements, TIF, or both divert funding from schools. In another 15 states, for either one or both of the subsidies, respondents did not know whether revenues were lost or diverted. Remarkably, only 4 states shield schools from both kinds of subsidies—Alaska, Florida, Maryland, and South Dakota.

We conclude, then, that schools in at least two-thirds of the states—and perhaps as many as four-fifths—are vulnerable to revenue lost to abatements and TIF. Table 3.1 shows states in which survey respondents indicated that abatements and TIF affect school revenue.

Table 3.1 States Where Abatements and TIF Affect School Revenue

	Survey question: Can school property taxes be abated for economic development?				*Survey question: Can school property taxes be diverted by TIF?*			
State	*Yes*	*No*	*Don't know*	*n.a.*	*Yes*	*No*	*Don't know*	*n.a.*
Alabama		■					■	
Alaska				■		■		
Arizona			■					■
Arkansas	■						■	
California			■				■	
Colorado	■				■			
Connecticut			■				■	
Delaware			■					■
Dist. of Columbia			■				■	
Florida		■				■		
Georgia			■				■	
Hawaii				■				■
Idaho				■			■	
Illinois	■				■			
Indiana	■				■			
Iowa	■				■			
Kansas	■				■			
Kentucky	■					■		
Louisiana	■					■		
Maine			■		■			
Maryland		■				■		
Massachusetts	■					■		
Michigan	■				■			
Minnesota	■				■			
Mississippi			■				■	
Missouri	■				■			
Montana			■		■			
Nebraska	■				■			
Nevada	■				■			
New Hampshire		■			■			
New Jersey	■						■	
New Mexico			■				■	
New York	■						■	
North Carolina	■							■
North Dakota	■					■		
Ohio	■				■			
Oklahoma	■				■			
Oregon		■			■			
Pennsylvania	■				■			
Rhode Island	■				■			
South Carolina	■				■			
South Dakota				■		■		
Tennessee	■						■	
Texas	■				■			
Utah				■	■			
Vermont			■				■	
Virginia				■			■	
Washington				■			■	
West Virginia				■			■	
Wisconsin				■	■			
Wyoming				■			■	
TOTAL	25	5	11	10	22	8	17	4

Source: Authors' survey results. n.a. = not applicable.

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Table 3.2 School Board Powers in Awarding Property Tax Abatements

School board area of authority	*States granting such authority*
Notification or opportunity to comment	Michigan, North Dakota, Ohio
Seat on advisory committee	North Dakota, Ohio
Must approve abatement of school property tax	Kansas, Minnesota, Ohio,* Pennsylvania, Texas
Informal influence	Missouri, Nebraska, Nevada, Ohio, South Carolina, Tennessee

*School boards can only vote on abatements that exempt more than 75 percent of taxes or that last longer than 10 years.

Table 3.3 School Board Powers in Tax Increment Financing

School board area of authority	*State(s) granting such authority*
Notification or opportunity to comment	Michigan, Minnesota, Ohio
Seat on advisory committee	Missouri, Nevada, Ohio, Wisconsin, Utah
Must approve any diversion of school taxes into TIF	Colorado, Michigan,* Ohio,‡ Oklahoma, Pennsylvania, South Carolina, Texas
Informal role	Montana

*School boards can only vote on the diversion of debt-services levies.

‡School boards can only vote on TIFs that divert more than 75 percent of the tax increment or that last longer than 10 years.

Finding 2: Very Few States Give School Boards Any Formal Powers

In most states, a majority vote of a city council or a county board settles decisions about abatements or TIF. We asked respondents whether school boards have any role—formal or informal—in the process. The overwhelming majority of states give school boards no formal authority. Instead, a few states merely require that a school district be notified when a TIF district or abatement is being considered, and some others allow school districts to comment or give school districts a seat on an advisory committee that oversees incentives.

Formal Power

Only Kansas, Minnesota, Ohio, Pennsylvania, and Texas give school boards a formal say about whether or not the school portion of property taxes may be abated. In Michigan, North Dakota, and Ohio, cities or local governments must notify school boards before granting abatements. In North Dakota and Ohio, school board representatives sit on a board that oversees tax abatements. Table 3.2 summarizes the powers of school boards in these 7 states. Respondents in 18 other states told us that school boards did not play any role in the awarding of tax abatements.

Similarly, only 7 states give school boards control over the diversion of school taxes into TIF (Colorado, Michigan, Ohio, Oklahoma, Pennsylvania, South Carolina, and Texas). In Oklahoma, creation of TIF districts requires school board approval, so school boards essentially have complete veto power. School boards are members of advisory committees in five states (Missouri, Nevada, Ohio, Wisconsin, and Utah). Michigan, Minnesota, and Ohio jurisdictions must notify the affected school boards before authorizing TIF. Table 3.3 summarizes these points.

In sum, only two states—Pennsylvania and Texas—give school boards formal power on both abatements and TIF.

Informal Power

Few respondents said that school districts have any *informal* power over the process. Interviewees reported isolated instances of school boards organizing to stop or modify a proposed subsidy, but most respondents felt that a school board could not successfully halt a subsidy deal unless substantial local opposition already existed.

A few respondents told of school boards and local governments negotiating informal, voluntary arrangements to reimburse the school districts for revenue lost to abatements or TIF. In some states, local governments have reimbursed schools by providing funding for specific services (e.g., construction of a gym or a school parking lot). Such arrangements reflect the school boards' informal power dynamic with the granting body.

It is also evident from the interviews that even in states where school boards have some role, they are often under considerable pressure to approve—or at least to not oppose—abatements or TIF districts. Indeed, school districts hungry for property wealth may be convinced that in the long run, the proposed subsidies will increase the local property tax base.

Finding 3: Some School Boards are Fighting Back; Others Get PILOT

Although many school boards have opposed TIF and abatements, only a handful have succeeded. Not surprisingly, most of these success stories are from states in which school boards have gained formal power in the subsidy-awarding process. School boards have reportedly been able to stop or exclude their taxes from TIF in seven states: Missouri, Nevada, Ohio, Pennsylvania, South Carolina, Texas, and Wisconsin. Only three states reported cases of school boards successfully opposing property tax abatements: Minnesota, Missouri, and Pennsylvania (see Appendix F). Historically, school boards in Texas have also opted out of tax abatements, although their action under a new abatement law has yet to be tested (Texas Senate Economic Development Committee 1996).

Occasionally school boards have become embroiled in fights with local governments over issues of reimbursement. Two respondents told of local governments that had negotiated payments in lieu of taxes (PILOT) with companies and then refused to share these payments with the school district (Survey respondent, personal communication, June 7, 2001). The Horry County School Board in South Carolina sued the county government over the distribution of such a payment.

Sometimes a company will agree to make a PILOT (also called a fee in lieu of taxes, FILOT) during the period in which it receives a property tax abatement. These in lieu payments are usually a fraction of what the company would have paid without an abatement. Respondents in 10 states reported that school boards could negotiate PILOT with companies. In four other states, the municipality negotiates PILOT and shares the proceeds with the school district (see Appendix G).

Table 3.4 notes the states in which school boards or municipalities, respectively, negotiate PILOT.

Table 3.4 States Granting Power to Negotiate PILOT to School Boards or Municipalities

States in which school board can negotiate PILOT	
Illinois	Nebraska
Kentucky	Nevada
Louisiana	Ohio
Michigan	Pennsylvania
Missouri	Texas
States in which municipality negotiates PILOT for schools	
Kansas	Rhode Island
New York	South Carolina

Finding 4: At Least a Third of States with Subsidies Fail to Reimburse School Districts Fully or at All

We also researched whether local school districts receive reimbursements for revenue they forgo from property tax abatements and TIF districts. States may provide such payments either directly through a specific program that provides dollar-for-dollar reimbursement or indirectly through the state school funding formula. Many states provide funds to local districts to compensate for differences in property wealth. In some cases, this aid offsets some of the losses from abatements and TIF. (For more information on how state aid offsets subsidies, see Appendix B on state school-funding formulas.)

Many school board officials believe that even when their state's formula provides some reimbursement for subsidies, they ultimately lose money because the formula funds are insufficient. In many states, state aid does not cover losses of revenues earmarked for capital outlay, debt service, or both. And many officials said that even if they were being reimbursed, they would prefer to have the revenue come from local sources instead of depending on state decisions about reimbursement. In other words, local control is important.

Respondents in 16 states reported that the state does not adequately reimburse school districts for revenue lost to property tax abatements. Respondents in 15 states reported that the state did not adequately reimburse local districts for school revenues diverted into TIF districts. In addition, 15 respondents did not know whether the states reimbursed school districts for abatements, and 16 respondents did not know whether state aid reimbursed school districts for TIF.

Several factors affect reimbursement from state aid. The most important is whether abated or "TIFed" property is included in the measurement of a district's property wealth in the school funding formula. Unfortunately, it is not always easy to tell. States have many different sources for measuring property wealth; some use actual receipts from previous years, whereas others use data from the tax assessors' office. Some respondents were uncertain how their own states' formulas operate in regard to economic development subsidies. Respondents in only two states—Oklahoma and Texas—were certain that TIFed property is included in the state's measurement of property wealth and that local schools therefore receive no state reimbursement.

Finding 5: The Tension Between Subsidies and Economic Growth is Visible

Questions about the relationship of subsidies and growth have emerged from several sources. Several interviewees noted that many abatements and TIF districts apply to new property values (i.e., new buildings or improvements on existing property), yet when economic activity expands, population also expands, and school districts have to hire more teachers and build more classrooms. States either do not reimburse districts for lost tax property tax revenues or do so only partially, but the schools still must educate the additional children. Their alternatives, then, are to forgo necessary improvements and programs or to increase the tax rate on residential or commercial property—both unpopular options.

These interviews directly contradict an argument commonly made by business lobbyists who claim that schools do not actually "lose revenue" because the property value stimulated by subsidies did not exist to be taxed before the improvement was constructed. The problem with the lobbyists' argument is that it presupposes that development would not take place without subsidies—an assumption that numerous studies and audits have challenged. It also does not account for the need to expand school resources to handle population growth.

Even libertarian and conservative groups have questioned the fairness of subsidies. Some libertarians oppose subsidies on the grounds that they constitute favoritism toward newly arriving companies at the expense of established firms. The John Locke Foundation (2000) has questioned the extent as well as the fairness of subsidies, criticizing North Carolina's "variety of special rates, exemptions, exclusions, deductions, and credits." The foundation noted that "in the corporate tax code alone, special tax credits for job creation, research and development, machinery, worker training, and other expenditures...total $263 million...or nearly a third of all corporate income taxes the state will collect."[2]

Another questionable aspect of the subsidy issue comes to light in a *Baltimore Sun* investigative series (Hancock 1999). The *Sun* put South Carolina's subsidy policies under detailed scrutiny and noted that the state had been giving local property tax abatements and generous state corporate income tax credits to a host of new factories. South Carolina's largesse with scarce public funds appeared highly problematic, the *Sun* thought, consider-

2. The John Locke Foundation, dubbed a "Heritage [Foundation] clone"; see Soley (1998).

ing that the state has the lowest SAT scores and eighth-most-deadly roads in the nation as well as 40 percent of its homes unconnected to sewer systems.

Finding 6: Several States Have Active Debates on the Issue; At Least 18 School Board Associations Have Researched or Lobbied the Issue

A handful of states have seen substantial activity around these issues. Debates are ongoing in Ohio, Pennsylvania, South Carolina and Texas. Generally, we found that states that rely heavily on property taxes or that use abatements and TIF are the most likely to be aware of the problem. School board associations were also more likely to be concerned if they felt that the state did not fairly reimburse them for revenue loss. Respondents in 18 states (see Appendix I for a list) reported that their organization had either researched subsidies or lobbied to change the laws that govern them. Many of these groups had tried to convince their legislatures either to protect school revenues from subsidies or to give school boards more power in the decisionmaking process.

4

Five States in Depth

In addition to conducting the 50-state survey of school boards and property tax subsidies we discussed in the previous chapters, we selected 5 states—Ohio, Florida, Minnesota, Montana, and Texas—for a more comprehensive analysis of economic development subsidies and school revenues. The choice of these particular states for study reflects the salience of the issue in the states; a desire for a degree of regional variety; and some informative differences in the states' regulatory treatment of subsidies (e.g., forbidding them, giving school boards oversight or veto powers, or doing nothing). It also reflects the availability of reasonably recent, complete, and manageable collections of data. We hasten to add that the case study states do not necessarily constitute a fully representative sample of the country. [3]

Methodology

How much revenue do schools forgo to development subsidies each year? One way to begin a calculation would be to take the value of abated property in each school district, multiply that by each respective district's property tax rate, and multiply it by the percentage of the property tax earmarked for schools. Another method would be to take the percentage of property tax revenue earmarked for schools (e.g., 50 percent) and multiply it by the total amount of revenue lost to property tax abatements and taxes diverted into TIF (if that amount is discernible).

We employed both of these methods to produce an estimate of the amount of revenue diverted from levies originally intended to fund education. We have also included an explanation of how the various state aid formulas interact with local development subsidies in an attempt to figure out which government body or bodies foot the bill for local tax breaks. For more information about the various state funding formulas referred to in these case studies, see Appendix B.

Case Study 1: Ohio

Economic development subsidies have created real problems for school districts in Ohio. Property tax abatements and TIF cost Ohio schools more than $100 million in potential tax revenue in 1999. The state and local school districts shared the burden of these revenue losses. The state shouldered most of the costs of local property tax

3. The accuracy of any overall analysis of the 50 states, of course, depends heavily on whether and how well a state collects the relevant information on property tax abatements and tax increment financing. Unfortunately, most states do not collect centralized information of this kind, and the states that do accumulate such data vary in the extent and quality of their record keeping. The basic goals of this preliminary study were to find how much revenue schools are losing to "business climate" subsidies in the case study states and to encourage further research and responses from states and localities that are aware of and interested in the issue.

breaks through state aid payments to local districts. Local school districts also lost potential revenue, however, because the state does not reimburse them for tax breaks affecting levies for capital outlay and debt service. School boards in Ohio do play an advisory role in economic development decisions, however.

School Funding

Ohio's school funding system has been a high-profile public issue for the last 10 years. The Ohio Supreme Court ruled in the *DeRolph v. State* decisions of 1997 (*DeRolph I and II*) that the school funding system was unconstitutional. In the decisions, the court defined a *thorough and efficient* education system as one that provided sufficient operating funds, numbers of teachers, and sound equipment and buildings to give all students an adequate education. The court found that dependence on revenues from property taxes caused insufficient and inequitable funding of property-poor districts. The court also cited the lack of state funding for building construction and maintenance. The state twice changed its funding system to provide greater spending per student and more appropriations for capital improvements. The changes included a two-year, $1.4 billion increase in state funding for education passed in spring 2001. Nonetheless, on September 6, 2001, another *DeRolph* (*DeRolph III*) ruling still found the funding system unconstitutional. This time, however, the court gave the legislature and the governor specific directions for bringing the system up to constitutional standards. The court declared that the state must increase the per-pupil foundation amount and phase in "parity aid" more quickly than it had planned. Protesting the cost of the court-ordered changes (estimates ranged from $300 million to as much as $1.2 billion annually), the state moved for reconsideration, and in December 2001 the court appointed a mediator to work with the parties. On March 21, 2002, the mediator issued a final report stating that mediation had failed to produce a resolution. The case, still unresolved, thus went back to the court's active docket.

Table 4.1 presents a summary of school funding for Ohio in 1998–99.

Ohio schools receive about half of their funding from property taxes. Ohio uses a foundation system in which local governments raise money for schools from property taxes, and the state provides additional aid to equalize spending between school districts. The state sets a budget for each district that is determined by multiplying the number of students by the foundation level. The state then dispenses foundation aid based on the number of students and the value of taxable property in each district. Local governments that receive state aid are required to tax property at a rate of at least 20 mills. The state compensates districts for an amount that equals the difference between the budget and the property taxes raised from a 23-mill levy.

(Number of students × foundation level)
− (Total local property value × .023)
= State aid

This formula applies only to basic operating costs and special education costs. The state provides categorical aid toward other costs, such as transportation and computers. The state recently began providing grants to fund school construction and maintenance for some of the poorest

Table 4.1 Ohio School Funding from State and Local Revenues, 1998–99

Funding source	*Amount ($)*
State school aid (all programs, total)	4.5 billion
Local school revenue (total),	6.0 billion
(Property tax)	(5.881 billion)
(Other local-source tax revenue)	(0.1205 billion)
(Local-source nontax revenue)	(0.0206 billion)
State and local school revenue (TOTAL)	**10.5 billion**

Source: U.S. Department of Education (2001).

districts in Ohio. Many local districts raise additional levies to cover these costs. The voters must approve such levies.

Economic Development Subsidies

Ohio offers several economic development subsidies that affect property tax revenues that schools receive. The state makes tax abatements on buildings and land (real property) available to firms located in enterprise zones, community reinvestment areas, and urban renewal areas. The state also allows exemptions from taxes on machinery and inventory (personal property) in enterprise zones. Community urban redevelopment corporation abatements exempt the value of improvements to real property in certain "blighted" areas.

Ohio has an unusual TIF provision that exempts improvements to specified parcels of land from taxation. Instead, annual service payments go into a TIF fund that finances public improvements. The state also exempts the first $10,000 of all personal property owned by businesses. Table 4.2 summarizes the types of local property tax incentives in Ohio.

School Boards' Role

About three-fourths of all property taxes collected in Ohio go toward education. Despite this fact, local governments, not school boards, control property tax exemptions. In recent years, school boards have gained a greater role in economic development decisions. Before granting tax abatements, local government officials must notify school districts and give them an opportunity to comment on the agreements. School boards must approve any tax abatements that exempt more than 75 percent of property taxes or that last more than 10 years. School board representatives also sit on tax incentive review councils. These councils have the authority to perform annual reviews of all tax exemption agreements and make recommendations to the governing body of the city or county.

Local Impact

The losses appear to be disproportionately concentrated in Ohio's historically more industrialized areas and thus appear to have hit urban school districts hardest. In Toledo, county auditor Larry Kaczala recently estimated that abatements cost the city school district $13.7 million annually in potential revenue (Tomsho 2001). School districts in the Cincinnati area (Hamilton County) lost more than $20 million in 1999 (Ohio Department of Taxation 1999b). A state audit of Cleveland public schools found that tax abatements granted to just eight downtown development projects cost the schools $9.2 million in 1996 (Petro 1996). During that same year, the school district was $150 million in debt. The district laid off teachers, cut sports programs, and closed schools.

In 1997, the Cleveland Teachers Union tried to pass a ballot initiative that would have forced either the city or the companies receiving abatements to reimburse the

Table 4.2 Local Property Tax Incentives in Ohio

Program	Type of property		Maximum abatement (%)	Maximum period of abatement (years)
	Real	Personal		
Enterprise zone				
Incorporated area	Yes	Yes	*75	*10
Unincorporated area	Yes	Yes	*60	*10
Community reinvestment area	Yes	No	100	15
Tax increment financing	Yes	No	*75	*10
Urban renewal debt retirement	Yes	No	*75	30
Community urban redevelopment	Yes	No	100	20

*School boards must approve anything above this threshold. *Source:* Ohio Department of Taxation (1998).

schools fully for the lost revenue. The ballot initiative failed, but the city council has since exercised more caution in awarding property tax abatements.

State Impact

In 1999, more than $3.3 billion of real property was exempt from taxation in Ohio (Ohio Department of Taxation 1999b). Multiplying this figure by the average school district tax rate for that same year yields an estimate that schools missed out on almost $102 million in revenue from property tax exemptions in that year alone (Ohio Department of Taxation 2000).

$3,327,428,725 X .03065 = $101,985,690

The state shouldered most of this revenue loss by providing aid payments to local districts. These are losses that the state can hardly afford in the current budget climate. Indeed, the Ohio legislature recently had to take $140 million out of its rainy day fund to cover budget shortfalls (McDonald 2001).

Ohio does not collect data on the aggregate value of exempt personal property in enterprise zones. This is a surprising omission in a state that has 240 enterprise zones.

State Reimbursement

In Ohio, the state aid formula partially reimburses local school districts for economic development subsidies. In essence, the state's aid payments enable local governments to achieve the foundation level of spending for each student. This practice does not reimburse school districts for losses on supplemental levies raised beyond the 23 mills prescribed by the foundation formula. In 1999, the average tax rate exceeded the foundation rate by about 7 mills (Ohio Department of Taxation 2000). These additional mills include voter-approved levies that cover the costs of building construction and maintenance.

The state does reimburse local governments for a standard exemption offered to all companies on $10,000 of personal property. In 1999, this deduction exempted $1.2 billion of personal property from taxation (Ohio Department of Taxation 1999a). Multiplying this figure by the average school district tax rate for personal property reveals that the state reimbursed local schools for approximately $58 million of lost personal property taxes (Ohio Department of Taxation 1999a).

$1,200,000,000 X 0.04827 = $57,924,000

Local Personal Income Tax Reimbursement

By law, local governments must share with schools some of the income tax benefits from subsidized economic development projects—that is, half of the value of individual income tax revenue generated by any new jobs in projects with at least $1 million of new payroll. This is a relatively new program, and the state does not collect data on it.

Reimbursement by Companies

Local governments and school districts can negotiate a payment in lieu of taxes (PILOT) with a company in an enterprise zone. Information on these agreements is only available for agreements executed beginning in 1999. In that year, the annual payments equaled $1,838,643 for PILOT negotiated that year.

Table 4.3 presents a summary of the information we gathered for Ohio.

Case Study 2: Florida

Florida schools receive about a third of their combined state and local funding (i.e., excluding federal funding) from local property taxes (U.S. Department of Education 2001). The state funds come principally from the state's general fund. Florida is one of only 9 states that do not levy personal income taxes, so the general fund relies heavily on sales tax revenue. Florida uses a foundation system to allocate state aid to local governments to support basic costs. In addition to the basic foundation aid, the state provides categorical aid to local districts for a variety of programs including capital outlay, technology, reduced class size, vouchers, and debt service. Table 4.4 presents a summary of school funding in Florida, 1998–99.

Local Economic Development Subsidies

Florida has three kinds of local tax incentives that affect property taxes: property tax abatements, enterprise zones, and tax increment financing. None of these affect schools, however, because Florida stipulates that local jurisdictions can abate or divert into TIF plans only county and city taxes. Florida explicitly forbids abatement or diversion into TIF of the school portion of local property taxes.

In addition, although the state allows the subsidies, state law requires voters of each county to approve an enabling referendum before county officials can start awarding property tax abatements. This requirement also

Table 4.3 Summary of Policies, Responses, and Effects of Subsidies in Ohio

Subsidy policy or response	*Amount / detail of effect*
School district taxes abated for economic development (real property only)	$101,985,690
School district taxes exempted from standard deduction of personal property	$57,924,000
School board role	Can veto any TIF or property tax exemptions that last more than 10 years or divert more than 75% of property taxes.
	Has a seat on tax incentive review council.
State reimbursement	Partial reimbursement through foundation funding formula.
	Full reimbursement for standard deduction of personal property.
Local reimbursement	Not available
Payments in lieu of taxes (PILOT) for deals negotiated in 1999	$1,838,643

Table 4.4 Florida School Funding from State and Local Revenues, 1998–99

Funding source	*Amount ($)*
State school aid (all programs, total)	8 billion
Local school revenue (total)	3.9 billion
(Property tax)	(3.9 billion)
(Other local-source tax revenue)	(0)
(Local-source nontax revenue)	(0)
State and local school revenue (TOTAL)	**11.9 billion**

Source: U.S. Department of Education (2001).

applies to tax abatements granted to businesses located in enterprise zones. Florida currently has 34 such zones, which offer both state and local tax breaks. Florida enterprise zones cost state and local governments about $68 million between 1995 and 1999. Local governments there also have the authority to create TIF districts.

State Economic Development Subsidies

Florida offers businesses a variety of incentives at the state level. These subsidies totaled $275 million in 2000 (Florida State Senate 2001: 44, 109–14). The state makes sales and corporate income tax breaks available to businesses located in enterprise zones, rural areas, and "urban high crime areas." Florida targets the sales tax exemptions at new manufacturing businesses, silicon technology companies, and businesses performing research and development. These subsidies have an indirect impact on school revenues by their effect on the state's general fund, which supplies about 60 percent of school funding. Table 4.5 presents a summary of the information we gathered for Florida.

Case Study 3: Minnesota

The 2001 legislative session in Minnesota gave extensive consideration to property taxes and school funding, in part because Governor Ventura staged a showdown with the legislature by refusing to sign any bills that did not adhere to his "revolutionary" tax proposal. The new legislation will eliminate local general education levies. School districts had depended on these levies as primary sources of local support. The new tax law also lowered the "class rates" for various types of property. Class rates determine the taxable percentage of a property's market value.

The elimination of the general education levy will reduce local property tax rates significantly in Minnesota,

Table 4.5 Summary of Policies, Responses, and Effects of Subsidies in Florida, 1998–99

Subsidy policy or response	*Amount ($) / detail of effect*
School district taxes abated for economic development	0
School district taxes diverted by TIF	0
State reimbursement	—
School board role	—
State economic development subsidy expenditures	275 million as of 2000

Note: — = information not available.

and it will shift more of the responsibility for funding education from local school districts onto the state. The general education levy had raised approximately $800 million in local property tax revenue (Minnesota Budget Project 2001). Under the new plan, the state promises to compensate districts for this lost revenue and to cover 78 percent of all funding (Sweeney 2001). Local school districts will continue to assess voter-approved supplemental property taxes.

The new tax structure will also reduce the amount of revenue that jurisdictions can use for TIF. This is no small issue in Minnesota, where TIF now captures about 8 percent of the entire state's property tax base. In fact, the general education levy had been a major source of funding for TIF projects; its elimination, along with reductions in class rates, will undoubtedly hurt TIF. Some experts are predicting a 40 percent drop in TIF revenues. The legislature has set aside $200 million to provide grants to TIF districts to help them adjust to the drop in revenues (Lowen 2001).

Current School Funding

Before the passage of the tax reform package, Minnesota used a foundation system to distribute state aid to local school districts. Under this system, the state calculated a budget for each district based on the number of students and the foundation level (cost per student). Local school districts had to contribute an amount equal to 32 percent of their net tax capacity in 2001 (the sum of the value of each parcel of land multiplied by the class rate assigned to it; Minnesota House Research Department 2002: 9). This contribution constituted the general education levy. The state covered the balance that the general education levy did not cover. In addition to the general education levy, school districts could raise supplemental taxes with the approval of the voters to cover capital costs, and, as noted, school districts will continue to levy these supplemental taxes under the new system. Table 4.6 summarizes Minnesota school funding, 1998–99.

Table 4.6 Minnesota School Funding from State and Local Revenues, 1998–99

Funding source	*Amount ($)*
State school aid (all programs, total)	3.8 billion
Local school revenue (total)	2.6 billion
(Property tax)	(1.980 billion)
(Other local-source tax revenue)	(0.028 billion)
(Local-source nontax revenue)	(0.580 billion)
State and local school revenue (TOTAL)	**6.4 billion**

Source: U.S. Department of Education (2001).

Economic Development Subsidies

TIF is by far the most popular tax incentive among local development officials in the Gopher State. In 1999, Minnesota had 2,103 TIF districts that captured $275 million in property tax revenue (Minnesota Office of the State Auditor 2001: 5–6). Before the 2001 tax reform, TIFs could capture revenue from the general education levy but not from supplemental school levies.

Property tax abatements, legalized only in 1997, are relatively new in Minnesota. Any taxing district can grant a property tax abatement for economic development. The Department of Trade and Economic Development did not start collecting data on abatements until recently. The only data available cover abatements granted during a 5-month period in 1999, when businesses got property tax abatements valued at $400,000. The state does not reimburse localities for these funds. In 2000, businesses in Minnesota received $3.7 million in abatements (this figure represents the value of the abatements over the duration of the subsidies, not fiscal 2000 alone; see Minnesota Trade and Economic Development Department 2002: 9).

School Board Role

School boards in Minnesota have limited powers over development subsidies. When a locality forms a TIF district, school boards have a chance to comment on it. But they cannot veto the TIF or exclude school revenue from TIF.

However, under the relatively new abatement law, school districts do have to approve the abatement of school taxes, and, again, the state aid formula does not reimburse the districts for the abatements.

State Impact

TIF has had a greater impact on Minnesota's state budget than it does on local school districts' budgets. This is because the state aid formula reimburses local school districts fully for any revenue lost to TIF. According to the Minnesota House Research Department, the state spent $112 million in state school aid in 1997 to offset revenue losses from TIF (Schroeder 1998).

The Future of TIF in Minnesota

TIF is likely to have a declining role in Minnesota. The state of Minnesota has now eliminated the general education levy on property that it formerly required localities to make. Under the general levy system, TIF districts could capture property tax revenue nominally intended for education. However, the state then reimbursed the schools commensurately, so the local education systems were largely unaffected. In essence, by allowing TIF districts to capture a portion of the local general education levy, the old system was providing a net tax subsidy to TIF-district projects that amounted to about $112 million.

Under the new system, with the state taking over the funding role formerly played by the local general education levy, the TIF districts will no longer have a local school funding stream to tap, and the state will no longer reimburse the local school districts. This thus ends the state's indirect subsidy of TIF. But TIF districts will not disappear, because local commitments run well into the future. Instead, funding for TIF districts will now have to come directly from city and county levies. This will not affect school funding, but cities and counties that have multiple TIF districts may have a difficult time levying enough money to sustain the ongoing TIF projects. Some experts are therefore predicting that municipalities will be more wary of making commitments to use TIF in the future (Kaszuba 2001). Table 4.7 summarizes the information for Minnesota.

Table 4.7 Summary of Policies, Responses, and Effects of Subsidies in Minnesota, 1998–99

Subsidy policy or response	*Amount ($) / detail of effect*
School taxes abated for economic development	400,000
School taxes diverted by TIF	112 million
State reimbursement	Full reimbursement for TIF
No reimbursement for abatements	
School board role	Advisory (notification and comment) on TIF
Consent/veto rights on abatements	
State economic development subsidy expenditures	275 million as of 2000

Source: Authors' interview data.

Case Study 4: Montana

School Funding

In February 1989, the Montana Supreme Court ruled the state's school finance system unconstitutional. The court found the school finance system overly dependent on local property taxes and judged that the state did not provide enough funding to ensure adequacy and equity ("equal opportunity for a quality education") among school districts. The state responded by establishing minimum and maximum budgets for each school district based on flat dollar payments to elementary school districts and, separately, to high school districts. In addition, the state provided more significant per student entitlements as well as guaranteed tax base (GTB) assistance to low-property-wealth school districts. School districts must raise enough money to fund the minimum, or "BASE," budget. The state, however, provides limited aid to local school districts. The state's share of education funding has actually declined since the enactment of this system from 71 percent for 1990–1991 to 62 percent for 1998–1999 and is projected to fall to 60 percent for fiscal 2003 (U.S. Department of Education 2001).

In Montana, the state distributes aid to school districts through two mechanisms: flat grants and guaranteed tax base (GTB) aid. Flat grants go to all school districts regardless of wealth, in proportion to the number of students in each district. GTB aid goes only to property-poor districts, in the form of state matching funds that supplement local property tax revenues. In the GTB program, the state uses a complex formula to set the rate at which it matches funds for each district. The formula takes into account the state GTB ratio (basically, the average number of property tax dollars per student); the value of flat grants the state provides the district; and the local tax capacity. Funding for both the flat grants and the GTB aid comes from a statewide property tax of 95 mills and additional state general fund appropriations (U.S. Department of Education 2001). Local school districts must fund the remainder of the BASE budget with revenues from property taxes; motor vehicle fees; oil, gas, and coal production taxes; direct investment earnings; and other nonlevy revenue.

This funding system has created new problems for Montana schools. In 2001, two property-poor districts filed suit against the state, complaining that they must set much higher tax rates than wealthier districts to cover their BASE budgets. More important, a second lawsuit, filed in September 2002 and based on "adequacy," involves the MEA-MFT and more than 50 Montana districts enrolling a majority of Montana's students. Many school districts also face a drop in state aid because of declining enrollments, as predominately rural Montana loses some of its younger families. Such districts face a funding squeeze because the state's aid declines in proportion to the loss in enrollment, whereas the districts' costs do not. That is, although schools with declining enrollments may be able to save on variable costs such as salaries and electricity bills, they cannot do so on fixed costs, such as construction debt or insurance payments. Meanwhile, an influx of affluent "amenity migrants" has driven up residential property values in some parts of the state, pushing up property tax assessments and prompting some homeowners to demand lower rates. Table 4.8 summarizes Montana school funding, 1998–99.

Table 4.8 Montana School Funding from State and Local Revenues, 1998–99

Funding source	*Amount ($)*
State school aid (all programs, total)	462.1 million
Local school revenue (total)	455.4 million
(Property tax)	(255.7 million)
(Other local-source tax revenue)	(134.0 million)
(Local-source nontax revenue)	(65.7 million)
State and local school revenue (TOTAL)	**917.5 million**

Source: U.S. Department of Education (2001).

Economic Development Subsidies

Montana offers businesses several tax breaks that affect school revenues. Local governments can offer property tax abatements to new and expanding businesses as well as to businesses that are remodeling their structures. Local governments also can exempt entire industrial parks and business "incubators" from taxation. These exemptions apply only to local school taxes, not to Montana's significant state property taxes.

Montana allows TIF, and the state currently has 20 TIF districts. Unlike abatements, TIFs divert both state and local property taxes that would otherwise go to schools.

School Board Role

School boards play no formal role in creating TIF districts or abating property taxes. However, local jurisdictions usually consult school boards before authorizing the formation of TIF districts. An official at the Montana School Board Association reported that school boards in Montana generally support TIF (personal communication, Montana School Boards Association, June 6, 2001). This is somewhat surprising, considering the fact that TIFs capture millions of dollars of school revenue each year.

Impact of Subsidies on School Revenues

According to the Department of Revenue, approximately $2.5 million in property tax revenue was lost to property tax abatements in 2000 (Tax Policy and Research 1998: 63). Of that amount, approximately $1.5 million would have gone to local school districts (proportion of local property taxes raised by school districts calculated from data in Tax Policy and Research 2000: 99). During that same year, TIF diverted approximately $24 million of property taxes. This amount includes both local and state property taxes—in all, about $13.6 million originally earmarked for education (Simshaw 2000: 12).

State Reimbursement

The complexity of Montana's school finance formula makes it hard to generalize about levels of state reimbursement to schools to mitigate the effects of corporate tax subsidies. Districts receive different amounts and types of state aid. All districts get the flat grants, which are not proportional to local property wealth or to levels of subsidy; the grants may lessen a district's dependence on local property taxes but are not specifically a reimbursement. GTB matching funds to property-poor districts are a partial reimbursement for subsidies because under the GTB formula, subsidies make districts appear poorer than they really are. That is, if a district has less taxable property because of abatements or TIF, the state matches local levies at a slightly higher rate.

Almost one-third of school districts in Montana receive no GTB aid (Montana Office of Public Instruction 2001) and hence no offset from the state for revenues lost to subsidies. Those areas must compensate by setting higher tax rates. To qualify for GTB aid, a district's GTB ratio (essentially, the ratio of local tax capacity to students in a district) must be lower than the state GTB ratio (ratio of statewide tax capacity to students in the state). Because TIFs and abatements lower a district's tax capacity, they may help some districts qualify for more GTB aid. Yet, TIFs and abatements also lower the statewide tax capacity, which may make it more difficult for some districts to qualify for state aid. Table 4.9 summarizes the information we gathered for Montana.

Table 4.9 Summary of Policies, Responses, and Effects of Subsidies in Montana, 1998–99

Subsidy policy or response	*Amount ($) / detail of effect*
School taxes abated for economic development	1.5 million
School taxes diverted by TIF	3.6 million
State reimbursement	None for districts that do not receive GTB aid
	Partial for districts receiving GTB aid
School board role	No formal role; consulted on an informal basis

Source: Authors' interview data. *Note:* GTB = guaranteed tax base.

Case Study 5: Texas

The Texas education system has experienced a dramatic transformation during the last 25 years, particularly in response to five major lawsuits against the Texas school system, each alleging that the system's overreliance on property taxes was creating inequalities between districts. After passing eight major school finance bills, the Texas legislature has most recently settled on a school finance system that uses both a foundation and a guaranteed-tax-yield formula to equalize disparities between districts.

Perhaps the most controversial component of this system involves a "Robin Hood" mechanism that takes excess revenues from wealthy districts and distributes them to poorer districts. This mechanism allows the state to use local property taxes in addition to state general fund revenues to equalize spending between districts. However, even with this enhancement in the resources available for state aid, Texas schools still derive half of their funding from local property taxes. The importance of the property tax in school funding has stoked a heated debate in Texas over the diversion of school taxes by economic development projects. This debate has yielded some interesting outcomes. Table 4.10 summarizes school funding in Texas, 1998–99.

School Boards' Role

Texas' economic development laws have changed over the years in response to the competing demands of schools and businesses. Until this year, school district property taxes were vulnerable to abatement or diversion into TIF. However, since 1987, school districts have had the power to exclude school levies from property tax abatements. They have also had the option of excluding their share of property taxes from enterprise zones and TIF districts. With this autonomy has come responsibility. In 1993, the state stopped reimbursing local districts for abatements through the state aid formula. Similar laws covered TIF. Since that time, school districts have approved fewer tax abatements, and the value of those approved has decreased significantly.

About 60 percent of Texas' local property taxes go to schools (Texas Comptroller of Public Accounts 1999: 1). Because of this, school boards often come under pressure from business leaders and local politicians to participate in abatements and TIF districts. A few years ago, some members of the legislature feared that corporations and others were bullying schools into giving away large shares of their budgets to abatements and TIF. In 1997, the Texas Senate passed a bill that would have prohibited schools from participating in standard abatements. The bill died in the House that session, but a similar law passed in 2001.

The state has created several subsidies that allow businesses to reduce their property tax bills. In 1997, the state started giving rebates to businesses on the school-designated portions of their property taxes. These rebates came from a state fund of $10 million a year. In 2001, the legislature passed a law creating a new property tax cut for large businesses. This law will cap the assessed value of large businesses at a level that depends on the total property wealth of the district. (To qualify for this cut, businesses must invest between $20 and $100 million in capital, depending on the size of the county.) For districts with less than $100 million in taxable property, the assessed value cap will be $20 million. For districts with more than

Table 4.10 Texas School Funding from State and Local Revenues, 1998–99

Funding source	*Amount ($)*
State school aid (all programs, total)	10.5 billion
Local school revenue (total)	10.9 billion
(Property tax)	(10.4 billion)
(Other local-source tax revenue)	(0.0)
(Local-source nontax revenue)	(0.546 billion)
State and local school revenue (TOTAL)	**21.4 billion**

Source: U.S. Department of Education (2001).

$10 billion, the cap will be $100 million. Businesses will pay no tax on the value of property above the cap. School districts still must approve this exemption, but here, unlike in other programs, the state will reimburse the schools for dollars lost to the subsidy. Some observers foresee very high costs to the state, especially for the largest business property owners, such as the state's petrochemical corporations.

State Reimbursement

Unlike Montana and Minnesota, the State of Texas does not reimburse any of its schools for taxes diverted by TIF. When calculating the level of aid it will provide, the state assumes that the district received taxes from the "TIFed" property. Hence, the subsidies make districts look wealthier than they really are. For poor districts, that means less state aid. For wealthy districts, it means bigger contributions to the Robin Hood fund. In both cases, districts lose revenue.

Between 1993 and 2001, the state stopped reimbursing schools for abatements. During that time, school districts exercised much more caution in offering these subsidies. Between 1993 and 1995, the percentage of school districts participating in any new tax abatements fell from 55 percent to 8 percent ([Texas] Senate Economic Development Committee 1996: 6). In 2001, the old abatement law phased out (via sunset provisions), and the state passed the new law described above allowing assessment caps. Under this new law, state aid goes to reimburse abatements.

Impact on Local and State Budgets

The state's tough reimbursement policy did not stop schools from awarding tax breaks altogether. According to the state comptroller, local school districts lost $52 million to abatements and TIF in 2000. One district alone, in Harris County, lost $15 million, mostly through the use of TIF (personal communication from Texas State Comptroller's Office, July 26, 2001). According to a report from the state legislature, almost all of the tax abatements executed since 1993 have been in low-wealth school districts ([Texas] Senate Economic Development Committee 1996: 8).

The state costs that local subsidies create are more difficult to calculate. The state still reimburses school districts for tax breaks awarded before 1993. According to the state comptroller's office, Texas abated $29 million in potential school revenue in 2000 (Texas State Comptroller's Office, personal communication, July 26, 2001). The state also offers rebates on school taxes to certain businesses, capped at a total of $10 million annually. The state will have to reimburse school districts for the new tax cap enacted for big businesses. The Legislative Budget Board estimates that this program will cost the state $117 million by 2007 (Texas General Assembly, Legislative Budget Board 2001). The prospect of such a large new cost prompted Governor Rick Perry to allow the bill to become law without his signature. Instead, he issued a cautionary statement about the bill's potential budget impact. Table 4.11 summarizes subsidy policies and costs for Texas, 1998–99.

Table 4.11 Summary of Policies, Responses, and Effects of Subsidies in Texas, 1998–99

Subsidy policy or response	*Amount ($) / detail of effect*
School district taxes abated for economic development and TIF	52 million
State corporate property tax rebate program	10 million
State reimbursement	None for tax increment financing.
	None for abatements negotiated between 1993 and 2001.
	Partial reimbursement for $29 million in abatements negotiated before 1993 and after 2001.
	Projected: A big surge in state costs because of new assessment cap for largest businesses.
School board role	Can exclude school portion of taxes from TIF and abatements

Source: Authors' case study notes.

5

Other Subsidies and Their Effect on State Revenues for Schools

Although this study focuses on local property tax losses, many other economic development subsidies affect *state* revenues. Most states offer companies exemptions or credits on corporate income, sales, utility, and inventory taxes. We have attached two tables from the Council of State Governments that detail tax and financial subsidies, respectively; the sheer number of such programs in most states today is enormous. Indeed, it is not unusual for a major deal to include more than a dozen different kinds of subsidies.

It is difficult to determine whether a state spends less on education—or how much less it spends—because of development subsidies. Education budgeting is very complex: both the availability of revenue and the demands placed on the education system influence it. Other influences on the level of state spending on education are election cycles, court challenges, local property tax rates, and additional services for children with special needs (Augenblick 2001b). We are not asserting here that revenue lost to subsidies results in a dollar-for-dollar decrease in education spending, but we are suggesting that to the extent that state development subsidies affect the amount of money available for schools, a relationship exists between state tax breaks and school finance. That said, the 20-year trend in enactment of development subsidies, and its impact on state budgets, is an undeniable influence on education spending.

Figure 5.1 shows state tax collections for 1998–99. As the figure shows, corporate income taxes account for 6 percent of all tax collections and are an important source of revenue for schools. Figure 5.2 shows states' general fund expenditures for the same period. Note that education spending accounts for more than a third of general fund expenditures, so any reduction in collections going into the general fund could hurt the schools. In particular, tax spending for economic development reduces already declining corporate contributions to the general fund, shifts the tax burden from corporations to individual taxpayers, or both.

Tables 5.1 and 5.2 show state tax incentives for business and state financial incentives for business, respectively, for 1998.

Figure 5.1 Percentages of State Tax Collections by Type, 1998–1999

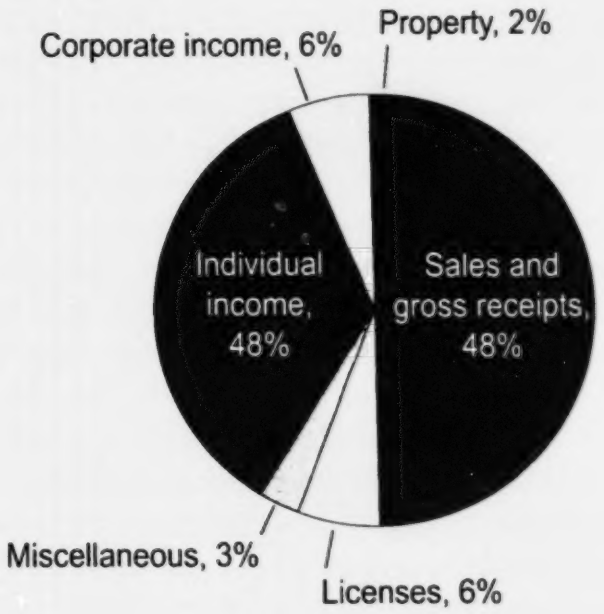
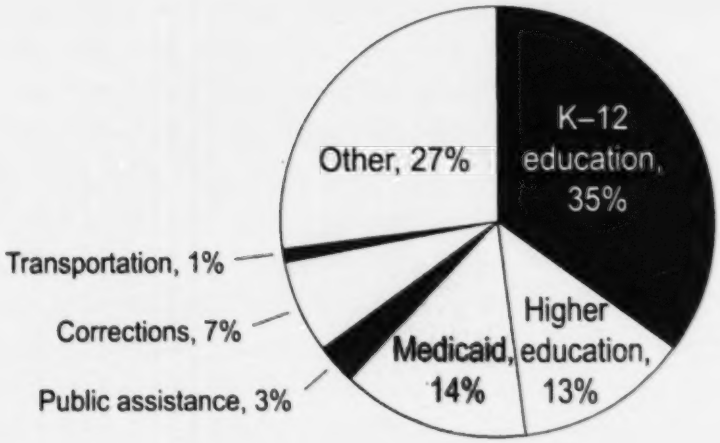


Figure 5.2. States' General Fund Expenditures, 1998–1999



Source: U.S. Census Bureau (2001) and National Association of State Budget Officers (2000: 8).

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Figure 5.1 State Tax Incentives for Business, 1998

State / Exemption / incentive	Corporate income tax exemption	Personal income tax exemption	Excise tax exemption	Tax exemption or moratorium: land / capital improvements	Tax exemption or moratorium: equipment / machinery	Inventory tax exemption on goods in transit (freeport)	Tax exemption on manufacturers' inventories	Sales/ use tax exemptions on new equipment	Tax exemptions on raw materials used in manufacturing	Tax incentives for job creation	Tax incentive for industrial investment	Tax credits for use of specified state products	Tax stabilization agreements for specified industries	Tax exemption to encourage research and development	Accelerated depreciation of industrial equipment
	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15
Alabama	■	■	■	■	■	■	■	■	■	■	■				■
Alaska		■	■	■					■			■			■
Arizona	■	■		■	■	■	■	■	■	■	■			■	■
Arkansas	■		■	■	■		■	■	■	■	■	■		■	■
California		■	■	■	■	■	■	■	■	■	■			■	■
Colorado	■		■		■	■	■	■	■	■	■				
Connecticut	■			■	■	■	■	■	■	■	■			■	■
Delaware	■	■	■	■	■	■	■	■	■	■	■			■	■
Florida	■	■	■	■	■	■	■	■	■	■	■			■	■
Georgia				■	■	■	■	■	■	■	■				■
Hawaii	■	■	■		■	■	■	■	■	■			■	■	■
Idaho	■				■	■	■	■	■		■			■	■
Illinois	■	■	■	■	■	■	■	■	■	■	■			■	■
Indiana	■	■		■	■	■	■	■	■	■	■			■	■
Iowa	■	■	■	■	■	■	■	■	■	■	■			■	■
Kansas	■	■		■	■	■	■	■	■	■	■			■	■
Kentucky				■	■	■	■	■	■	■	■			■	■
Louisiana	■	■		■	■	■	■		■	■	■		■	■	■
Maine	■	■			■	■	■	■	■	■	■			■	■
Maryland	■	■	■	■	■	■	■	■	■	■	■			■	■
Massachusetts	■	■	■	■	■	■	■	■	■	■	■		■	■	■
Michigan	■	■		■	■	■	■	■	■	■	■				■
Minnesota			■	■	■	■	■	■	■	■			■	■	■
Mississippi	■	■			■	■	■	■	■	■	■			■	■
Missouri	■	■	■	■	■	■	■	■	■	■	■			■	■
Montana	■	■		■	■	■	■	■	■	■	■	■	■	■	■
Nebraska		■		■	■	■	■	■	■	■					■
Nevada	■	■	■			■	■	■	■	■					
New Hampshire		■			■	■	■	■	■	■	■				■
New Jersey	■	■		■	■	■	■	■	■	■	■			■	
New Mexico				■	■	■	■	■	■		■			■	■
New York	■	■	■	■	■	■	■	■	■	■	■			■	
North Carolina						■	■	■	■	■	■			■	
North Dakota	■		■	■	■	■	■	■	■	■	■			■	
Ohio	■	■		■	■	■	■	■	■	■	■			■	■
Oklahoma	■	■	■	■	■	■		■	■	■	■	■	■	■	■
Oregon			■	■	■	■	■	■		■				■	■
Pennsylvania	■		■	■	■	■	■	■	■	■	■	■		■	■
Rhode Island			■	■	■	■	■	■	■	■	■	■	■	■	■
South Carolina	■			■	■	■	■	■	■	■	■			■	■
South Dakota	■	■	■	■		■	■		■	■	■			■	■
Tennessee	■	■	■	■	■	■	■	■	■		■			■	■
Texas	■	■		■	■	■		■	■	■	■				
Utah					■	■	■	■	■	■					■
Vermont			■			■	■	■	■				■		■
Virginia	■	■		■	■	■	■	■	■	■	■			■	■
Washington	■	■	■			■	■	■	■	■	■			■	
West Virginia	■	■		■		■	■	■	■	■	■	■	■	■	■
Wisconsin	■	■			■	■	■	■	■	■	■			■	■
Wyoming	■	■	■			■	■		■						
STATE TOTALS	37	34	28	38	42	48	46	47	50	43	43	7	9	38	41

Source: Council of State Governments (2000), citing data compiled from the magazine *Site Selection* (1998).

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Table 5.2 State Financial Incentives for Business, 1998

State / Incentive	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16
Alabama	■	■	■		■	■	■	■	■	■			■	■	■	■
Alaska	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■
Arizona					■	■	■	■			■	■	■		■	■
Arkansas	■	■	■	■	■	■	■	■	■	■	■	■	■		■	■
California	■	■	■	■		■	■	■	■	■	■	■	■		■	■
Colorado	■	■			■		■	■	■	■	■	■	■	■	■	■
Connecticut	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■
Delaware	■	■	■		■		■	■	■	■			■	■	■	■
Florida		■	■		■	■	■	■	■	■			■		■	■
Georgia	■	■	■		■	■			■	■					■	■
Hawaii	■		■	■	■	■	■	■					■		■	■
Idaho		■			■	■			■	■						
Illinois	■	■	■		■		■	■	■	■			■		■	■
Indiana	■	■	■		■	■	■	■	■	■			■		■	■
Iowa	■	■	■		■	■	■	■	■	■	■	■	■	■	■	■
Kansas			■	■	■	■			■	■		■	■		■	■
Kentucky	■		■	■	■	■	■	■	■	■			■	■	■	■
Louisiana		■	■	■	■	■	■	■	■	■	■	■	■	■	■	■
Maine	■		■		■	■	■	■	■	■	■	■	■		■	■
Maryland	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■
Massachusetts	■	■	■		■	■	■	■	■	■	■	■	■	■	■	■
Michigan	■	■	■		■	■	■	■	■	■			■	■	■	■
Minnesota	■	■	■	■	■	■	■	■	■	■			■	■	■	
Mississippi	■	■	■	■	■	■	■	■	■	■	■	■	■		■	■
Missouri	■	■	■		■	■	■	■	■	■	■	■	■		■	■
Montana		■	■	■	■	■	■	■	■	■			■			
Nebraska	■	■	■	■	■		■	■	■	■	■	■	■	■	■	■
Nevada	■	■	■	■	■	■				■					■	■
New Hampshire	■	■	■		■	■			■	■	■	■	■			
New Jersey	■		■		■	■	■	■	■	■	■	■	■		■	■
New Mexico	■	■	■	■	■	■	■	■	■	■			■		■	■
New York	■	■	■	■	■		■	■	■	■	■	■	■		■	■
North Carolina	■				■	■			■	■					■	
North Dakota		■	■	■	■	■	■	■	■	■	■	■	■	■	■	■
Ohio	■	■	■		■		■	■	■	■			■	■	■	■
Oklahoma	■		■	■	■	■	■	■	■	■	■	■	■	■	■	■
Oregon	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■
Pennsylvania	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■
Rhode Island	■	■	■	■	■		■	■	■	■	■	■	■	■	■	■
South Carolina	■	■	■		■	■	■	■	■	■			■		■	■
South Dakota	■	■	■		■	■	■	■	■	■			■	■		
Tennessee			■	■	■	■	■	■	■	■	■	■	■	■	■	
Texas	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■
Utah	■	■			■	■			■	■					■	
Vermont	■	■	■		■	■	■	■	■	■	■	■	■	■		
Virginia	■	■	■		■	■	■	■	■	■			■		■	■
Washington	■	■	■		■			■				■		■	■	
West Virginia	■	■	■		■		■	■	■	■	■	■	■	■		
Wisconsin	■		■		■	■	■	■	■	■			■		■	
Wyoming	■	■	■		■	■	■	■	■	■	■	■	■	■		
STATE TOTALS	42	39	45	24	49	41	42	43	47	47	28	30	44	27	43	37

Source: Council of State Governments (2000), citing data compiled from the magazine *Site Selection* (1998).

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Conclusion

Subsidies vary in their impact on school revenues from state to state, but in more than half of the states, property tax abatements, TIF, or both have a negative effect on school revenues. Revenue losses to education are greater in states such as Ohio, which depend more on property taxes for school finance and offer numerous subsidies to businesses. The losses are not as severe in states that depend less on property taxes for school finance, such as Minnesota, which has apparently limited the potential impact of subsidies on school revenues by adjusting the school-funding formula. Schools lose no property tax revenue to development subsidies in a very few states, including Florida, that specifically shield school revenues from the effect of tax breaks.

The impact of subsidies on schools depends a great deal on how states distribute aid to local school districts. A few states eliminate the effects of tax subsidies to corporate developers by making up the entire losses in property tax revenues to the schools. In others, state aid reimburses districts only for revenue earmarked for basic operating costs but not for capital costs; their schools thus continue to run but may face problems when buildings need significant maintenance or replacement. Several states, such as Texas, provide school districts with no reimbursement at all for property tax revenue lost to abatements and TIF. Overall, more than half of the school board officials surveyed believe that their state does not fully reimburse these losses.

Ultimately, working families and unsubsidized businesses bear the costs of economic development subsidies. It is they who must pay higher taxes to replace the revenues diverted to subsidized corporations and thereby maintain or expand public services to meet demand. Or it is they who must put up with degraded levels of services—more potholes in the streets, fewer teachers in the classroom, fewer computers in the labs, fewer health services, less frequent bus service, and so on. Whether individuals and nonsubsidized businesses pay up or put up, they are the ones who are stuck when some companies get a free pass on property taxes. Even when the state increases aid payments to offset the costs of abatements and TIF, it either must squeeze taxpayers at the state level or it must allocate less money other to education priorities, transportation, safety, health care, and so on.

When the local school districts do not get reimbursement from the state for subsidies, the school boards must press for increased local tax rates or cut educational services. The dilemma is disturbing, because many state supreme courts have been ruling that school funding is inadequate and inequitable under current conditions, so it is clear that many districts can ill afford to make further cuts in response to loss of funding to subsidies. If the

choice seems to come down either to raising taxes or to cutting public services, the public should consider cutting development subsidies to corporations as an alternative.

Fortunately, educators and school boards are becoming increasingly aware of the harm done through the often-subtle tax expenditures that create abatements and TIF. In at least 19 states, school board associations have either researched or campaigned around or are already demanding a larger role in subsidy decisions—a role that will protect the funding and quality of public education.

Further information on the specific funding formulas and local property taxes appears in Appendix B for those who are interested in assessing the impact of subsidies and potential ways of protecting public education funding.

Education unions have a role to play in this debate. As the front-line workers who see the impact of overcrowding and other effects of underfunded schools, teachers and classified employees can articulate the direct impact subsidies have on tomorrow's work force.

Most school boards and education organizations still lack any direct power to affect the process of granting subsidies for development. Yet even businesses have been highlighting the availability of a highly skilled pool of labor in their siting decisions (see, e.g., Moline 1998; Mayfield 1999; and King and Gramko 1999). That is, educated, skilled workers want to give their children good educations as well. If businesses are more willing to recognize the problematic connection between property tax subsidies and the health of their present and future work forces, perhaps they will also be willing to reconceptualize the components of a "business climate" to involve fewer subsidies on property taxes and fuller funding for education. That is something on which unions, school boards, and business could work together. It is a long-term strategy, however. In the meantime, this report has raised several concerns:

- In many states, data collection on subsidy deals is so poor that it is almost impossible to measure the costs and the outcomes of these programs, much less hold beneficiaries responsible if they do not perform as promised.
- School officials have very little say over these programs.
- Abatements and TIF cost schools millions of dollars in revenue each year.

To address these issues, we offer three policy recommendations below.

1: Improve Disclosure of Subsidies and Enforce Standards

States should measure the impact of subsidies on school revenue. In order to do this, they must collect reliable data on property tax abatements and TIF and aggregate it by school district, county, and state. School boards and the public should have full, advance information about subsidies so that they can make informed decisions. In addition, the public does not need to bear the brunt of a mistake if a development agreement provides for a clawback of subsidies given to developers who have failed to meet their promises on jobs, wages, or capital investment.

2: Give Local School Boards Authority in Subsidy Decisions

Giving school boards a formal say in subsidy decision-making is another line of defense for school funding. We strongly recommend that school boards should have veto power over abatements and TIF.

3: Press State Government to Shield School Revenues from the Effects of Subsidies

One of the best ways to protect school revenues from being depleted by business subsidies is for the state government itself to prohibit the abatement or diversion of the school portion of property taxes. As we noted earlier, a small handful of states have already done this. Most states, however, protect schools from property tax subsidies only partially (typically to reimburse operating losses) or not at all. Some states also protect school levies earmarked for capital outlay or debt service from abatement or diversion into TIF. More could do so. By promoting exclusion of funds for schools' capital outlay or debt service in states that do reimburse districts for schools' operating expenditures, local districts could create a shield made up partly by reimbursement and partly by statutory or regulatory restriction of the scope of subsidies. The permutations of such combined approaches will of course vary with the particular statutes and practices in each state.

Appendix A: Research Methodology and Scope

Literature Search

We searched for news articles and research reports on the relationship between subsidies and school revenue. We found a handful of reports that looked at the issue in particular states but could only identify one 50-state overview, a 1993 report by the U.S. General Accounting Office, performed at the request of Senator Howard Metzenbaum of Ohio. Most of the studies we found focus on the debate surrounding school finance reform.

Statute Review

For each state, we reviewed the statutes that govern tax increment financing, property tax abatements, and enterprise zones. We sought to find out whether these programs affect school district revenues. We also looked for information about the role of school boards in making decisions about granting economic subsidies. We used this information to inform our interviews with state school board association officials.

Survey of State School Board Associations

We administered a telephone survey of school board associations in 49 states and the District of Columbia to collect basic information about the role of school boards in subsidy decisions and the impact of subsidies on school revenues, focusing especially on abatements and TIF. When conducting the survey, we started by speaking with a staff member of each state's school board association. Surprisingly, these association staffers frequently had to refer us to other sources, such as departments of education, state tax assessment departments, or advocacy organizations. In 13 states, we were unable to find any answers to our questions from all such sources. In eight more states, our results are incomplete because association officials were only familiar with one of the two subsidies. We did not survey school board officials in Hawaii because that state finances its schools almost entirely from state revenue (Appendix C lists the organizations we interviewed in each state).

Case Studies

For five states—Florida, Minnesota, Montana, Ohio, and Texas—we sought to paint a more detailed picture of the issue by calculating the amount of school revenue lost to economic development tax breaks. We did the following research:

- Found data on development subsidies by contacting departments of revenue and economic development, and state comptrollers
- Reviewed tax expenditure budgets for estimates of revenue lost to development subsidies (property tax abatements, tax increment financing, and other significant tax breaks)
- Reviewed detailed explanations of school finance systems from the National Center for Education Statistics, the National Education Association, and state sources
- Conducted on-line and telephone-interview searches about activity on the issue, including trends, legal issues, prevalence of the problem, and local disputes and organizing around the issue
- Interviewed additional groups that might have a stake in the issue, such as local school boards, departments of education, community groups, and teachers' unions.

Appendix B: State Funding Formulas and Local Property Tax Subsidies

Funding for K–12 education in nearly every state comes from three sources: local, state, and federal governments. Through the 1960s, local governments had virtually sole responsibility for education, financing schools primarily with revenue raised from property taxes. During the past 30 years, however, states have come to bear an increasing share of education spending, reducing schools' reliance on local property taxes. In the United States as a whole, however, local property taxes still account for 29 percent of school revenues, and other local sources provide 16 percent, so that local sources account for a combined average of 45 percent of total school funding (48 percent comes from state governments, 7 percent from the federal government).

The local–state funding mix varies significantly among states. Local governments provide 87 percent of all funding in New Hampshire but only 2 percent in Hawaii. How much a state contributes to any given district is based on a complex formula intended to supplement funding for all districts, to equalize funding among districts, and to provide a basic level of funding in all districts. Table B.1 summarizes sources of education funding by state.

Local Funding

Local governments raise most of their money for education through local property taxes. Most entities with taxing authority (i.e., cities, counties, and other taxing districts such as water and school) can set their own tax rates, collect the tax, and distribute it according to a budget. School spending typically accounts for half or more of the property revenues raised locally.

Local governments cannot always spend as much of their property tax revenue as they want on education. Some state funding formulas cap the amount that a district can spend or the rate at which a district can tax in order to equalize funding among districts. States then supplement local revenues according to formulas (discussed below). Local governments may also raise additional funding, usually with voter approval, through sales or income taxes or additional property taxes. They often earmark these taxes or levies for education, especially for capital expenses such as school construction and maintenance.

State Funding

State formulas for allocating revenue among local school districts vary greatly and have evolved over the years. Many of the changes in school funding formulas have come from state supreme court decisions finding that state funding systems have failed to meet state constitutional provisions for equal protection and basic education guarantees. Several common themes have arisen from these court cases. Many courts have ruled that education funding is the responsibility of the state, not the local governments. Courts have also ruled that local systems of funding that rely on property taxes create inequities among school districts. These rulings have prompted states to fund a greater share of education costs and to lessen schools' reliance on local property taxes.

States provide two types of aid to districts. *Basic aid* covers the largest portion of education costs. The state distributes this aid according to complex formulas that take into account the differing needs and relative wealth of districts. *Categorical aid* goes for special programs such as bilingual education, transportation, or building construction and maintenance. Categorical aid exists "outside the formula" and may not always reflect a district's relative wealth.

States use four kinds of basic aid formulas. Although they are individually very different, these formulas all seek to address disparities among school districts' capacity to generate revenue. The basis of most states' formulas is some measurement of the local district's ability to pay, generally defined as the value of taxable property in the district, known as "net tax capacity." The state usually adjusts the net tax capacity for each district for differences in assessment practices among districts. State formulas take other factors into account as well, such as personal income in the district, the number of children receiving free lunches, and other indicators of relative wealth or poverty. The formulas also factor in each district's costs, including the number of students, weightings for grade level, special education considerations, teachers' salaries, and real estate prices.

Outlined below are the four kinds of basic aid formulas. For the purposes of this report, we are interested in

Table B.1 Sources of Education Funding (%)

State	Local	Intermediate	State	Federal
United States	44.5	0.4	48.4	6.8
Alabama	27.7	0.5	62.5	9.4
Alaska	25.6	0.0	62.2	12.3
Arizona	41.8	3.7	44.3	10.2
Arkansas	31.4	0.1	57.7	10.8
California	31.6	0.0	60.2	8.2
Colorado	51.3	0.2	43.4	5.1
Connecticut	58.8	0.0	37.3	3.9
Delaware	28.0	0.0	64.4	7.6
District of Columbia	83.5	0.0	0.0	16.5
Florida	43.6	0.0	48.8	7.6
Georgia	42.0	0.0	51.2	6.8
Hawaii	2.4	0.0	89.0	8.6
Idaho	30.3	0.0	62.7	7.0
Illinois	64.8	0.0	28.4	6.7
Indiana	43.1	0.7	51.4	4.8
Iowa	43.2	0.2	51.3	5.3
Kansas	32.6	3.6	57.9	5.9
Kentucky	28.7	0.0	61.7	9.6
Louisiana	38.3	0.0	50.4	11.3
Maine	47.5	0.0	45.5	7.0
Maryland	55.8	0.0	39.0	5.2
Massachusetts	54.3	0.0	40.7	5.0
Michigan	27.3	0.1	66.0	6.6
Minnesota	39.5	3.2	52.3	4.9
Mississippi	30.5	0.0	55.4	14.1
Missouri	53.6	0.5	39.7	6.2
Montana	33.9	9.0	46.9	10.2
Nebraska	59.5	0.7	33.1	6.7
Nevada	63.6	0.0	31.8	4.6
New Hampshire	86.8	0.0	9.3	3.8
New Jersey	56.6	0.0	39.8	3.6
New Mexico	14.6	0.0	72.2	13.2
New York	54.4	0.4	39.7	5.4
North Carolina	25.5	0.0	67.3	7.2
North Dakota	45.5	1.1	41.1	12.4
Ohio	52.8	0.2	41.2	5.8
Oklahoma	27.9	1.9	61.6	8.6
Oregon	35.3	1.5	56.8	6.4
Pennsylvania	55.4	0.1	38.7	5.9
Rhode Island	54.4	0.0	40.1	5.4
South Carolina	40.0	0.0	51.5	8.5
South Dakota	53.2	1.2	35.6	10.0
Tennessee	43.4	0.0	47.7	8.8
Texas	47.9	0.3	44.2	7.6
Utah	32.1	0.0	61.0	6.9
Vermont	65.4	0.0	29.4	5.2
Virginia	63.4	0.0	31.4	5.2
Washington	27.6	0.0	66.0	6.4
West Virginia	28.1	0.0	62.7	9.2
Wisconsin	41.8	0.0	53.7	4.5
Wyoming	38.4	7.8	47.0	6.7

Source: U.S. Dept. of Education, NCES, Common Core of Data, "National Public Education Financial Survey: School Year 1996–97."

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how the state handles the question of ability to pay, in particular how the state assesses local property wealth.

- *Flat grants.* These provide each "unit" (number of pupils or teachers) with a designated amount of state aid dollars. Because the amount granted does not depend on local property wealth or taxing effort, property tax abatements or TIF will not affect the amount of such aid that the state gives local school districts.
- *Foundation programs.* The majority of the states use this method, by which the state commits to ensuring a minimum level of funding per pupil. This is the *foundation.* Instead of a flat dollar amount, the state provides school districts with aid on a sliding scale intended to cover the foundation costs for each student. The states vary in whether they require local jurisdictions to impose a minimum tax rate.

  In most states' foundation programs, the state first establishes a baseline level of funding that each student needs to get a good education. Then, the state determines each local government's ability to raise the money to reach that foundation for all of its students. If local property taxes are insufficient, then the state pays the difference. State aid is determined by multiplying the number of students in a district by the foundation and then subtracting the required local effort (tax rate multiplied by the total value of the district's tax base).

  State aid = (No. of students X Foundation) –
  (Tax Rate X Property Values)
- *Guaranteed Tax Base (GTB) or Guaranteed Tax Yield (GTY) programs.* These focus on equalizing the ability of local school districts to raise revenue rather than on establishing a basic level of funding per student. Under the GTB system, the state will match the dollars that a local school district raises. The more money a district raises, the more dollars the state provides. Under the GTY system, the state provides matching funds to guarantee a specific dollar amount that a given local tax rate raises. Both systems create incentives for districts to raise higher taxes to support schools.
- *Full funding programs.* In these programs, the state assumes full financial responsibility for school funding. Local property tax revenues do not go toward education spending, so property tax abatements and TIF cannot affect school funding.

Most states fund special programs (special education, transportation, capital outlays) through categorical aid. States are less likely to base this aid on local districts' ability to pay, even though local school districts fund some of these programs through supplemental levies. When local governments abate these supplemental taxes, they frequently do not receive state reimbursement for the consequent revenue losses.

Reimbursement against Subsidies

In most cases, state aid provides a certain level of reimbursement to school districts that have lost revenue to subsidies. The method that a state uses to distribute basic aid to local districts determines how much reimbursement a district will receive. Most states take some measure of net tax capacity into account in measuring a local district's ability to pay for education. If a state includes all property in a district when it estimates local property wealth, including property that does not actually contribute to the schools because of an abatement or TIF, then the state will commensurately overestimate the affected district's net tax capacity. That, in turn, means that the state will not reimburse the district for the revenue lost to the abatement or to TIF. On the other hand, if a state excludes the value of tax-abated or TIF-captured property from the locality's tax capacity, then the schools may get reimbursement for some or all of the resulting revenue loss.

Some states impose expenditure and revenue limits for local schools to help equalize school spending between districts. These limits are relevant to determining how TIF or abatements affect school revenues. If a state imposes spending limits and agrees to help local districts reach these limits through a foundation formula, then school budgets are fixed and not vulnerable to depletion from abatements or TIF. That is, the state will shoulder the cost of the subsidies by providing higher levels of aid. If a state does not create a spending limit or a taxing limit, then school districts could raise more funds than the amounts prescribed in a foundation formula. In that case, the state would only be providing a partial reimbursement for the subsidy, and the state and local governments would be sharing the costs of the subsidy.

Categorical aid is a different story. States do not always distribute categorical aid according to property wealth, so they do not always reimburse local governments for sub-

sidies they grant that deplete local contributions to categorical programs. A good example is categorical aid for building construction and maintenance. In some states, local school districts levy special property taxes—called capital outlay and debt service levies—to pay for these costs. Because the state does not always reimburse the local governments for the revenues lost to subsidies based on these levies, these sources of school funding are particularly vulnerable. For this reason, some states specifically prohibit diversion of these supplemental taxes into TIF. In Iowa, for example, the school board association successfully lobbied to exclude capital and debt service levies from TIF.

The question of reimbursement is critical to this study. If a state fully reimburses a district for a local subsidy, then the state bears the burden of paying for the tax incentives local governments grant to businesses. If the state provides no reimbursement, then the local schools bear the burden alone. If the state provides partial reimbursement, then the state government and local school districts share the burden. The reimbursement question is clearly not a simple matter of whether states provide aid to local school districts. Often it is a question of the duration and depth of that aid. In fact, many of the school board officials we queried felt and probably still feel that state aid does not sufficiently reimburse local school districts for dollars lost to abatements and TIF.

Appendix C: Organizations Surveyed

State	*Organizations*	*Survey complete?*
Alabama	Alabama Legislative Service Bureau	TIF incomplete
Alaska	Association of Alaska School Boards	Yes
Arizona	Arizona School Boards Association	No
Arkansas	Arkansas School Boards Association	No
California	California School Boards Association	No
Colorado	Colorado Association of School Boards	Yes
Connecticut	Connecticut Association of Boards of Education	No
Delaware	Delaware School Board Association	No
District of Columbia	District of Columbia Board of Education	TIF incomplete
Florida	Senate Finance and Taxation Committee	Yes
Georgia	Georgia School Boards Association	No
Idaho	Idaho School Boards Association	No
Illinois	Illinois Association of School Boards	Yes
Indiana	Indiana School Boards Association	Yes
Iowa	Iowa Association of School Boards	Yes
Kansas	Kansas Association of School Boards	Yes
Kentucky	Kentucky School Boards Association	Yes
Louisiana	Louisiana School Boards Association	Yes
Maine	Maine School Boards Association	Abatement incomplete
Maryland	Maryland Association of Boards of Education	Yes
Massachusetts	Massachusetts Association of School Committees	Yes
Michigan	Michigan School Business Officials	Yes
Minnesota	Minnesota School Board Association	Yes
Mississippi	Mississippi School Board Association	No
Missouri	Missouri School Boards' Association	Yes
Montana	Montana School Boards Association	Abatement incomplete
Nebraska	Nebraska Association of School Boards	Yes
Nevada	Nevada Association of School Boards	Yes
New Hampshire	New Hampshire School Boards Association	Yes
New Jersey	New Jersey Education Association	TIF incomplete
New Mexico	New Mexico School Boards Association	No
New York	New York State School Boards Association	TIF incomplete
North Carolina	North Carolina School Boards Association	Yes
North Dakota	North Dakota School Boards Association	Yes
Ohio	Ohio School Boards Association	Yes
Oklahoma	Oklahoma Senate Finance Committee & Education Appropriations Subcommittee	Yes
Oregon	Oregon School Boards Association	Yes
Pennsylvania	Pennsylvania School Boards Association	Yes
Rhode Island	Rhode Island Association of School Committees	Yes
South Carolina	South Carolina School Boards Association	Yes
South Dakota	Associated School Boards of South Dakota	Yes
Tennessee	Tennessee School Boards Association	TIF incomplete
Texas	Texas Association of School Boards	Yes
Utah	Utah Department of Education	Yes
Vermont	Vermont - National Education Association	No
Virginia	Virginia School Boards Association	TIF incomplete
Washington	Washington State School Directors' Association	No
West Virginia	West Virginia School Boards Association	No
Wisconsin	Wisconsin Association of School Boards	Abatement incomplete
Wyoming	Wyoming School Boards Association	No

No = Respondents were unable to answer questions because they were not familiar with subsidies.
TIF incomplete = Respondents were unable to answer questions because they were not familiar with TIF.
Abatement incomplete = Respondents were unable to answer questions because they were not familiar with abatements.

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Appendix D: Roles of School Boards in Awarding Property Tax Abatements

State	Do boards play a formal role in granting abatements?				Nature of board's role			
	Yes	No	Don't know	n.a.	Approval power	Advisory	Committee Seat	Informal
Alabama				■				
Alaska				■				
Arizona			■					
Arkansas			■					
California			■					
Colorado	■							
Connecticut			■					
Delaware			■					
District of Columbia		■						
Florida				■				
Georgia			■					
Idaho			■					
Illinois		■						
Indiana			■					
Iowa		■						
Kansas	■				■			
Kentucky		■						
Louisiana		■						
Maine		■						
Maryland				■				
Massachusetts		■						
Michigan	■					■		
Minnesota	■				■			
Mississippi			■					
Missouri		■						■
Montana				■				

Appendix D continues on next page

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Appendix D (continued)

	Do boards play a formal role in granting abatements?				*Nature of board's role*			
State	*Yes*	*No*	*Don't know*	*n.a.*	*Approval power*	*Advisory*	*Committee Seat*	*Informal*
Nebraska		■						■
Nevada		■						■
New Hampshire				■				
New Jersey		■						
New Mexico			■					
New York	■	■						
North Carolina		■						
North Dakota	■					■	■	
Ohio	■				■	■	■	■
Oklahoma		■						
Oregon				■				
Pennsylvania	■				■			
Rhode Island		■						
South Carolina		■						■
South Dakota				■				
Tennessee		■						■
Texas	■				■			
Utah				■				
Vermont			■					
Virginia		■						
Washington			■					
West Virginia			■					
Wisconsin			■					
Wyoming			■					

Appendix E. Roles of School Boards in Tax Increment Financing

State	Does school board play formal role in creating TIF districts?				What is school board role re diversion of school taxes for TIF?			
	Yes	No	Don't know	n.a.	Approval power	Advisory	Seat on board	Informal
Alabama			■					
Alaska				■				
Arizona				■				
Arkansas			■					
California			■					
Colorado	■				■			
Connecticut			■					
Delaware				■				
District of Columbia			■					
Florida				■				
Georgia			■					
Idaho			■					
Illinois		■						
Indiana		■						
Iowa		■						
Kansas		■						
Kentucky				■				
Louisiana				■				
Maine		■						
Maryland				■				
Massachusetts				■				
Michigan	■				■*	■		
Minnesota	■					■		
Mississippi			■					
Missouri	■						■	
Montana		■						■

Appendix E continues on next page

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Appendix E (continued)

State	Does school board play formal role in creating TIF districts?				What is school board role re diversion of school taxes for TIF?			
	Yes	No	Don't know	n.a.	Approval power	Advisory	Seat on board	Informal
Nebraska		■						
Nevada	■						■	
New Hampshire		■						
New Jersey			■					
New Mexico			■					
New York			■					
North Carolina				■				
North Dakota		■						
Ohio	■				■	■	■	
Oklahoma	■				■			
Oregon		■						
Pennsylvania	■				■			
Rhode Island		■						
South Carolina		■			■			
South Dakota				■				
Tennessee			■					
Texas	■				■			
Utah	■						■	
Vermont			■					
Virginia			■					
Washington			■					
West Virginia			■					
Wisconsin	■						■	
Wyoming			■					

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Appendix F. School Board Opposition to Abatements, TIF

State	*Has a school board ever stopped school taxes from being abated or stopped an abatement?*				*Has a school board stopped school taxes from everbeing diverted by TIF or stopped a TIF?*			
	Yes	No	Don't know	n.a.	Yes	No	Don't know	n.a.
Alabama				■			■	
Alaska				■				■
Arizona			■					■
Arkansas			■				■	
California			■				■	
Colorado			■				■	
Connecticut			■				■	
Delaware			■					■
Dist. of Columbia		■					■	
Florida				■				■
Georgia			■				■	
Idaho			■				■	
Illinois		■					■	
Indiana		■					■	
Iowa		■					■	
Kansas		■					■	
Kentucky		■						■
Louisiana		■						■
Maine		■				■		
Maryland								
Massachusetts		■						■
Michigan		■				■		
Minnesota	■							■
Mississippi			■					
Missouri	■				■			
Montana			■	■			■	
Nebraska		■				■		
Nevada		■			■			
New Hampshire				■		■		
New Jersey		■					■	
New Mexico			■				■	
New York		■					■	
North Carolina		■						■
North Dakota		■				■		
Ohio		■			■			
Oklahoma		■					■	
Oregon				■		■		
Pennsylvania	■				■			
Rhode Island		■				■		
South Carolina		■			■			
South Dakota				■				■
Tennessee		■					■	
Texas	■				■			
Utah							■	
Vermont			■				■	
Virginia		■					■	
Washington			■				■	
West Virginia			■				■	
Wisconsin			■		■			
Wyoming			■				■	

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Appendix G. Can School Boards Negotiate a Payment in Lieu of Tax (PILOT)?

State	Yes	PILOT negotiated by municipality	No	Don't know	School taxes not abatable
Alabama					■
Alaska					■
Arizona				■	
Arkansas				■	
California				■	
Colorado			■		
Connecticut				■	
Delaware				■	
Florida					■
Georgia				■	
Idaho				■	
Illinois	■				
Indiana				■	
Iowa			■		
Kansas		■			
Kentucky	■				
Louisiana	■				
Maine			■		
Maryland					■
Massachusetts			■		
Michigan	■				
Minnesota				■	
Mississippi				■	
Missouri	■				
Montana				■	
Nebraska	■				
Nevada	■				
New Hampshire					■
New Jersey			■		
New Mexico				■	
New York		■			
North Carolina				■	
North Dakota			■		
Ohio	■				
Oklahoma			■		
Oregon					■
Pennsylvania	■				
Rhode Island		■			
South Carolina		■			
South Dakota					■
Tennessee			■		
Texas	■				
Utah					■
Vermont				■	
Virginia			■		
Washington				■	
West Virginia				■	
Wisconsin				■	
Wyoming				■	

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Appendix H. State Reimbursement for Abatements, TIF

State	Abatement reimbursed	How	Amount ($)	TIF reimbursed	How	Amount
Alabama	n.a.			Don't know		
Alaska	n.a.			n.a.		
Arizona	Don't know			n.a.		
Arkansas	Don't know			Don't know		
California	Don't know			Don't know		
Colorado	Yes	State aid	2-3 million	Yes	State aid	$6 million
Connecticut	Don't know			Don't know		
Delaware	Don't know			n.a.		
Dist. of Columbia	No			No		
Florida	n.a.			n.a.		
Georgia	Don't know			Don't know		
Idaho	Don't know			Don't know		
Illinois	No			No		
Indiana	No			No		
Iowa	Yes	State aid	Don't know	Yes	State aid	87% of lost value
Kansas	No			No		
Kentucky	Yes	State aid	Don't know	n.a.		
Louisiana	Yes	State aid	Don't know	n.a.		
Maine	No			Yes	Don't know	
Maryland	n.a.			n.a.		
Massachusetts	No			n.a.		
Michigan	Yes	State aid	Don't know	Yes	State aid	Don't know
Minnesota	No			Yes	State aid	Don't know
Mississippi	Don't know			Don't know		
Missouri	No			No		
Montana	n.a.			No		
Nebraska	Yes	State aid	Don't know	No		
Nevada	No			No		
New Hampshire	n.a.			Yes	State aid	Don't know
New Jersey	No			Don't know		
New Mexico	Don't know			Don't know		
New York	No			Don't know		
North Carolina	Don't know			n.a.		
North Dakota	No			No		
Ohio	No			No		
Oklahoma	Yes	Special fund	$23.6 million	No		
Oregon	n.a.			Yes	State aid	Don't know
Pennsylvania	No			No		
Rhode Island	Yes	State aid		Yes	State aid	
South Carolina	No			No		
South Dakota	n.a.			n.a.		
Tennessee	No			Don't know		
Texas	Yes	State aid		No		
Utah	n.a.			No		
Vermont	Don't know			Don't know		
Virginia	Don't know			Don't know		
Washington	Don't know			Don't know		
West Virginia	Don't know			Don't know		
Wisconsin	n.a.			Yes	State aid	
Wyoming	Don't know			Don't know		

Key: n.a. = not applicable; respondent thought that subsidy did not affect school property taxes. Don't know = respondent not familiar with subsidy or reimbursement procedure.

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Appendix I. States in Which School Board Association Engaged in Subsidy Debate

State	Worked on issue	Researched issue	Lobbied on issue
Alabama			
Alaska			
Arizona			■
Arkansas			
California			
Colorado			
Connecticut			
Delaware	■	■	
Florida			
Georgia			
Idaho			
Illinois			■
Indiana	■		
Iowa	■	■	■
Kansas			
Kentucky			
Louisiana			■
Maine	■	■	
Maryland			
Massachusetts			
Michigan	■	■	
Minnesota	■	■	
Mississippi			
Missouri	■		■
Montana	■	■	
Nebraska	■		■
Nevada			
New Hampshire			
New Jersey			
New Mexico			
New York	■		■
North Carolina			
North Dakota	■		■
Ohio	■		■
Oklahoma			
Oregon	■	■	
Pennsylvania	■	■	
Rhode Island			
South Carolina	■	■	■
South Dakota			■
Tennessee			
Texas	■		■
Utah	■	■	■
Vermont			
Virginia			
Washington			
West Virginia			
Wisconsin	■		■
Wyoming			

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